Stanford – Vienna
Transatlantic Technology Law Forum

A joint initiative of
Stanford Law School and the University of Vienna School of Law

TTLF Working Papers

No. 89

Buy Now, Pay Later ("BNPL") Under Regulatory Scrutiny – The Evolving Regulatory Landscape for BNPL in the United States, the United Kingdom, and Europe

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2022

TTLF Working Papers

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General Note about the Content

Suggested Citation

This TTLF Working Paper should be cited as:
Diana Milanesi, Buy Now, Pay Later ("BNPL") Under Regulatory Scrutiny – The Evolving Regulatory Landscape for BNPL in the United States, the United Kingdom, and Europe, Stanford-Vienna TTLF Working Paper No. 89, http://ttlf.stanford.edu.

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Abstract

The recent Covid-19 pandemic has accelerated the digitalization of finance and the migration of buyers online. Compounded by the pandemic, banking and financial services have undergone rapid and transformational changes, and the significant growth of digital commerce has led to record online payment volumes in both mature and developing markets. In addition, customer behavior and expectations have significantly evolved - today's customers demand more digital and connected experiences and greater convenience, transparency, and personalization.

The combination of these factors has helped pave the way for the emergence of buy now, pay later ("BNPL"), which has quickly gained popularity with customers and retailers of all kinds. BNPL providers challenge traditional lending and point-of-sale financing business models such as credit cards by leveraging innovative technology and offering fast, frictionless, and accessible finance to a broader audience. As the name implies, BNPL allows customers to purchase products and pay for them in installments over a short period of time, typically at zero or low interest. BNPL firms offer seamless, flexible, and integrated financing experiences and usually perform only 'soft' credit checks on applicants. BNPL credit is typically extended to customers at the point of sale – online and in-store. Customers may use BNPL solutions through merchants who embed BNPL products in their check-out processes or via BNPL platforms enabling customers to shop anywhere in installments. BNPL companies tend to generate most of their revenues by charging fees to merchants for the services provided. Some BNPL providers also derive revenues from interest charges on longer-term BNPL loans and/or late fees or penalties charged to customers who fail to make the required BNPL payments on time.

BNPL transaction volume has rapidly increased in recent months, and further growth is expected over the next few years. Although the rise of BNPL has been particularly pronounced among younger cohorts like Millennials and Generation Z, BNPL adoption is growing steadily across other age demographic segments. Moreover, while fashion, technology, health, and beauty are the top categories for BNPL purchases, BNPL solutions are progressively broadening their reach to cover new verticals, including healthcare, hospitality, travel, and entertainment. As the BNPL market progresses on its rapid growth trajectory, significant capital flows into BNPL businesses. Competition is also quickly mounting, while consolidation is expected to accelerate as certain BNPL firms come to dominate in various geographies and acquire smaller rivals.

Thus far, fintech companies have taken the lead and have captured most of the value being created in the BNPL market. As the BNPL market evolves, fintech BNPL providers are expected to expand into deeper, more connected, and more frequent relationships with customers. These companies are increasingly rethinking and advancing BNPL products to make them more suitable and appealing to customers and businesses. Some fintech firms will continue focusing on servicing e-commerce merchants across an increased number of BNPL verticals and potentially branch into in-person consumption channels. Other BNPL fintech providers will likely cross into trade and business-to-business BNPL credit. Fintech BNPL players with higher levels of consumer loyalty and more active customer bases are expected to broaden the scope of their activities and build significant scale and engagement through the entire

customer journey via “super apps,” offering a fully integrated ecosystem of financial and non-financial products and services shaped around users’ everyday needs.

While fintech BNPL providers continue innovating at speed, more established market players enter the BNPL space and join the race. Large technology companies and incumbent financial institutions increasingly see BNPL as a strategic area to deepen customer and merchant relationships. They are now considering the right BNPL business model to focus on, the verticals to prioritize, and how to go to market - from partnering with BNPL firms, to competing with them, to financing or acquiring them. Their future decisions will be key to watch as they leverage their extensive networks of merchants and partners and their customer bases and seek to evolve their offerings in response to rapidly changing consumer expectations and needs. Whichever approach they choose, large technology companies and financial incumbents must recognize that BNPL is part of a broader transformational change of the financial and banking industry into a more transparent, open, connected, and experience-driven ecosystem.

More and more customers around the world choose BNPL for simplicity of use and accessibility. When BNPL products are used correctly, customers can enjoy accessible and low-cost credit, seamless purchasing and financing experiences, flexible repayment schedules, and an increased ability to manage their cash flow and control their finances. BNPL solutions can also help unlock customer purchasing power and offer customers the opportunity to easily try out a product with no financial outlay at the time of purchase. In addition to helping customers, BNPL can provide significant advantages to merchants, as well. Merchants using BNPL solutions have recorded considerable improvements in key business metrics, including average order values and sales conversion rates. Moreover, merchants can use BNPL features to enhance customer experience and their customer acquisition and retention strategies. Merchants partnering with BNPL firms can also increase the exposure of their brand and offerings to existing and new customers and leverage their customer data and insights to better understand customer behavior, tailor their offerings to meet customer needs, and improve the value proposition of their loyalty programs.

Despite these positives, BNPL products are not without risks. Although BNPL firms typically offer interest-free payments to customers, some also charge late fees or other penalties if a customer fails to pay on time. Moreover, many BNPL firms report missed payments to credit reference agencies, meaning a customer’s credit score could be negatively impacted if the customer misses any required payment. Some customers may fail to appreciate the credit nature of the BNPL offers they are taking on and may, therefore, not apply the same level of scrutiny as they would otherwise do with traditional forms of credit. For some customers, the availability of BNPL credit during the check-out process may also encourage impulse buying. This concern is amplified by ‘soft’ credit checks and limited affordability assessments run on BNPL customers, which may lead to unsustainable levels of debt and cause consumers to take on more debt than they can afford and then struggle to repay it. These risks become even more relevant when paired with the use of complex and lengthy terms and conditions by certain BNPL firms, inconsistent practices in the BNPL market, as well as the lack of consumer protections otherwise applicable to traditional forms of credit (including disclosure requirements, resolution procedures and specific requirements around how to treat customers falling into difficulty).

Concerns have also been raised in relation to the absence of mandatory reporting to a regulatory body and credit bureaus, and the shortfall of data relating to BNPL transactions shared between BNPL companies and other lenders, which may contribute

significant opacity to the credit market and make tracking BNPL credit across multiple providers very difficult. Moreover, protecting BNPL customers' data and personal information has emerged as a further area of growing concern as the risk of data and cyber security threats intensifies.

In addition to the foregoing, critics have noted that most BNPL firms have so far scaled their activities in relatively benign market conditions. Over the last few years, the abundance of capital in private markets has created a relatively 'cheap' funding environment for BNPL firms to finance their operations, often at very high market valuations despite being loss-generating companies. Moreover, record-low interest rates have driven flows into the consumer credit market and have helped BNPL providers offer credit to consumers for no or very low interest while generating significant revenues from merchant fees (and, in some instances, late payment charges). However, these market conditions have rapidly changed in recent months, thus putting increased pressure on BNPL firms, driving up their cost of doing business, and causing some of them to reconsider their growth and expansion plans. Significant uncertainty remains as to the longer-term viability of the business models adopted by certain BNPL specialists, which are increasingly being tested due to fluctuations in the quality of credit performance, reduced merchant fees and narrow margins driven by increased competition, interest rate hikes, and the anticipated impact of future regulatory reforms. As the macroeconomic environment deteriorates further and public markets are down, BNPL providers are grappling with the prospect of an economic downturn. Some BNPL providers now face increased skepticism from investors and have a much harder time raising money, in some instances at considerably lower valuations and less favorable terms compared to their most recent funding rounds. Even the largest and best-funded BNPL providers have reported significant net losses. In response, they are considering (or have already announced) plans to cut their expenses in an effort to extend their runways, are shifting their activities away from growth 'at all costs' toward sustainable profitability, and are trying to diversify their revenue streams and sources of funding.

Furthermore, in recent months inflation has increased to reach its highest rates and the costs of living have risen dramatically, with the prices of non-discretionary items such as food and fuel rising the fastest. While this has caused a slowdown in consumer spending, it has also forced more people to turn to BNPL or similar forms of credit to pay for basic goods and services when they can't immediately afford purchases. As more customers lean into BNPL products to cover essentials, concerns have emerged that more individuals may plunge into debt and struggle to pay their debts, and that default rates may sky rock and leave BNPL firms absorbing larger credit losses in the months to come.

The global consumer uptake of BNPL and the associated risks discussed above have caught the attention of regulators in the United States, the United Kingdom, and Europe, among others, and have highlighted the need for greater regulatory oversight. Although BNPL providers have been mainly operating outside of existing regulatory frameworks, the regulatory climate has been heating up, and scrutiny has significantly intensified in recent months. Regulators are quickly taking stock and are working to bring BNPL into their remit to improve the fairness, transparency, and integrity of the BNPL market and protect consumers from irresponsible lending and data-collection practices. Regulators are now deliberating on the implications of BNPL models, investigating the benefits and dangers created by BNPL offerings and assessing how to draw the boundary for BNPL regulation appropriately and proportionally to the

associated risks. As with any fast-growing industry, the interplay between innovation, technology, and regulation will be a delicate balancing act. The future regulatory activity would need to be proportionate and balance the need to strengthen consumer protection and increase transparency and efficiency in the BNPL market, while also ensuring continued access to BNPL by customers and merchants and allowing innovation to flourish. Determining the appropriate scope of any future regulatory intervention in the BNPL market will require a nuanced analysis of evolving consumer behaviors and needs and an in-depth examination of consumer benefits and risks.

Current and prospective participants in the BNPL market are closely following the recent regulatory developments and watching for indications of the scope and impact of further regulatory activity and regulation expected to arrive in the near term. BNPL firms are encouraged to take appropriate steps to address relevant risks proactively. Going forward, transparent, clear, and fair BNPL terms and conditions, coupled with an intuitive, seamless, and flexible user experience, will play an increasingly important role in creating a best-in-class customer journey and better outcomes for customers and businesses. In addition, BNPL firms will likely need to provide more transparent guidance, simple communications, and educational initiatives to increase consumers' awareness, help consumers understand how BNPL works and how to use it responsibly, and empower them to make informed decisions. Those BNPL providers who accelerate the work to build robust compliance procedures, improve risks and credit decision models, enhance data-sharing practices, develop effective fraud prevention and collection capabilities, and increase consumer protections and guardrails will be able to provide greater control and value to the end consumers, while also gaining more visibility and a better understanding of their credit and financial behavior. To continue to be relevant, BNPL firms will also need to carefully assess the impact of the evolving macro context of inflation and the shifting economic outlook on their performance and their customers' spending and financing activities and evolve their offerings accordingly.

Undoubtedly, careful planning and common industry standards will play a pivotal role in delivering responsible credit alternatives and promoting long-term sustainable growth in the BNPL market, which in turn will help enhance the benefits and value to consumers and businesses. Informed guidance by regulators and policymakers and collaboration between them and the BNPL industry will be critical to shaping the future of the BNPL market while continuing to offer consumers innovative and empowering choices to manage and control their finances effectively.

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PREFACE

The Covid-19 pandemic has led to significant structural changes in the banking and financial services industry by accelerating the shift to digital and driving strong growth in e-commerce, digital payments, and embedded finance. Consumer expectations have shifted from traditional lending and payment products toward low-cost and free products and services with convenient, intuitive, and integrated digital experiences. Against this backdrop, BNPL has risen to the scene to become a popular financing option for consumers.

BNPL products offer consumers the option to defer or split up payments for specific purchases into installments. Shorter-term BNPL products are typically interest-free, while longer-term BNPL products may charge interest. Although BNPL was initially utilized primarily for low-value online purchases, it has rapidly expanded to in-store purchases and has become prominent across various products and use cases, including electronics, clothing and fashion items, furniture, and more recently also travel and health care. Indicative of the growth potential of the BNPL market, some BNPL providers are now expanding beyond offering embedded checkout solutions to provide aggregated e-commerce offerings via single mobile interfaces. Some BNPL providers have gone a step further by integrating a virtual prepaid card linked to the user's account that works with any merchant online and in-store, while others have started offering a variety of seamlessly integrated financial and non-financial products and services via 'super-apps.'

As BNPL appeals to a mass consumer market on a global scale and its growth trajectory accelerates, significant capital flows into high-growth BNPL businesses, and cross-industry consolidation and partnerships increase. Competition is also mounting as large technology and fintech businesses extend their products further into BNPL and some of the biggest banks and card providers worldwide move into the BNPL market by launching their own BNPL offerings, partnering with BNPL providers, or acquiring them.

Customers find certain features of BNPL products to be particularly compelling, including the simplicity of payment at checkout, the intuitive navigation and interface, the ability to manage the cash flow more efficiently by deferring payments, the interest-free nature of BNPL products, the ability to unlock purchasing power, and the opportunity to try selected items before being charged for them. BNPL products can also bring significant advantages to merchants, who can benefit from a seamless checkout experience, improved customer performance, new customer acquisition, higher basket conversion, increases in average order value, new customer referrals, and enhanced brand exposure. Notwithstanding these benefits, BNPL products carry their own set of risks and challenges. Concerns have been raised as to whether BNPL products may cause overuse and debt spirals across multiple providers, may encourage impulse buying (particularly among young and financially vulnerable individuals) and may contribute opacity to the credit market due to limited credit data sharing between BNPL companies and the other lenders. Moreover, critics have warned that BNPL products may be made available to customers without disclosure of all material information and without an accurate assessment of the consumer's ability to repay loans, thus creating the risk of repeated defaults and missed payments, which could result in late fees, penalties or high interest and could hinder the consumer's ability to access credit in the future.

The rise of BNPL and the risks associated with BNPL products have come under significant regulatory scrutiny in recent months. UK regulators have already begun taking steps to regulate the BNPL industry, while EU regulators are actively looking into passing new regulations on BNPL. In the United States, regulators are assessing the extent to which BNPL products may be covered by existing consumer protection laws at federal and state levels, are collecting information and data from BNPL market participants, are encouraging BNPL users to be informed about risks and their consumer protection rights and have even entered into settlement agreements with certain BNPL providers.

Against this background, this paper takes a closer look at the evolving regulatory landscape for BNPL across three main geographic areas – the United States, the United Kingdom, and Europe. The paper is organized as follows:

- Chapter 1 provides a brief overview of BNPL products, examines the key benefits and risks of BNPL for consumers and merchants, and highlights recent BNPL market trends.
- Chapter 2 discusses the increased regulatory scrutiny of BNPL in the United States.
- Chapter 3 analyzes recent regulatory developments relating to BNPL in the United Kingdom.

- Chapter 4 examines the evolving regulatory framework of BNPL in Europe.
- Chapter 5 offers insights into how the BNPL is likely to evolve.

CHAPTER 1

BNPL OVERVIEW AND MARKET INSIGHTS

1.1 What Is BNPL?

BNPL is taking center stage as an increasingly popular form of short-term financing that allows customers to make purchases and then delay or spread the cost of their purchases over a set period, usually without incurring interest or other charges.

Certain BNPL providers allow customers to buy selected items through flexible installments with no interest or penalties if paid on time. The purchase cost is typically split over three or four interest-free payments, with the first payment made at check-out and subsequent payments deducted automatically to avoid late fees. Customers can shop online with their preferred merchants, on the BNPL provider app/website, or in-store, and the 'pay in x' installment functionality is presented and selected at check-out. Customers who opt to pay with BNPL are typically redirected to the BNPL provider's app/website, which shows a timeline for installment payment. The customer confirms basic information that enables the BNPL provider to perform a 'soft' real-time inquiry on the customer's credit. Once approved, the customer agrees to the BNPL provider's terms and conditions and privacy policy and provides a payment account that the BNPL provider can charge or debit in installments. After the customer completes the transaction with the BNPL provider, the customer is typically redirected to the retailer's site for order confirmation. The BNPL provider pays the total purchase price upfront to the merchant in exchange for a fee, and the customer then pays installments over time to the BNPL provider. This form of BNPL is utilized for a variety of purchases, typically of mid to low value. Examples of major BNPL installment providers include Quadpay and Sezzle (both acquired by Australian largest BNPL provider Zip in 2021[1] and 2022,[2] respectively), Afterpay (acquired by Block (formerly, Square) in 2021[3]), and Klarna.

Other BNPL providers allow customers to buy selected items through fixed-rate interest-bearing loans at the point-of-sale ("POS") when fees are known upfront. The loan terms vary by provider, with six months to three years terms being the most common. The BNPL provider pays the total purchase price upfront to the merchant, and the customer pays a specified amount to the BNPL provider. The loans are either securitized or maintained on the balance sheet of the BNPL provider throughout the term of the loans. Customers are typically subject to 'soft' credit inquiries and risk-adjusted interest rates. If the customers fail to pay the POS loans, they are usually subject to late fees and removal from the platform. Missing payments on POS loans also have the potential to impact credit scores. Many merchants that integrate this financing solution are in categories with higher-ticket, lower-frequency purchases where

[1] See, Zip and Quadpay, Quadpay Joins Forces with Zip and Raises $130M in Funding, Zip and Quadpay Press Release (July 22, 2021); Business Wire, Zip and Quadpay Unveil New Unified Brand to Strengthen Position in the Global BNPL Ecosystem, Business Wire (July 22, 2021).

[2] See, Zip and Sezzle, Zip announces definitive agreement to acquire Sezzle, Zip and Sezzle Press Release (February 28, 2022); Byron Kaye and Sameer Manekar, Australia's Zip to buy U.S. buy-now-pay-later rival Sezzle amid softening market, Reuters (February 28, 2022); Finextra, Zip confirms deal to acquire US BNPL player Sezzle, Finextra (February 28, 2022); Nic Fildes, Australia's biggest 'buy now, pay later' company buys rival to drive US push, Financial Times (February 28, 2022).

[3] See, Square, Square, Inc. Announces Plans to Acquire Afterpay, Strengthening and Enabling Further Integration Between its Seller and Cash App Ecosystems, Square Press Release (August 1, 2021); Dave Lee and Jamie Smyth, Square to acquire Afterpay for $29bn as 'buy now, pay later' booms, Financial Times (August 2, 2021); Mary Ann Azevedo, Square to buy 'buy now, pay later' giant Afterpay in $29B deal, TechCrunch (August 2, 2021).

acquisition costs are relatively high, and cart conversions are extremely important. Common verticals include furniture and home goods, electronics, sports equipment, and travel. Notable examples of POS financing providers include Affirm and Klarna.

BNPL providers have been adopting different business models. Among them, the most common variations are the following:[4]

- Certain BNPL providers sell to merchants who then embed their financing solutions into the customer journey, either online or in-store at the POS. In this 'embedded' model, merchants pay the provider a service fee for the embedded credit service and its ability to increase commercial metrics, including conversion and cart size.
- Other BNPL providers sell directly to customers to capture their payment volume and interest revenue. In this 'merchant-agnostic' model, BNPL providers' proprietary apps and web platforms combine the roles of e-commerce aggregator and affiliate marketer and enable the customers to apply BNPL solutions to any purchase (independent of the merchant) by issuing them a virtual card or a similar payment tool. BNPL providers typically charge an affiliate commission and/or an interchange fee.

While smaller and relatively new BNPL players primarily adopt the former business model, leading BNPL providers are increasingly embracing the latter approach. A number of leading BNPL providers like Clearpay, Klarna, Zip, and Laybuy are expanding beyond offering embedded check-out solutions to introduce proprietary mobile applications that aggregate multiple e-commerce offerings in one interface and help customers search for and buy a variety of products and services and finance purchases in a single interface. Some providers like Klarna, Zilch, and Laybuy have deployed a direct-to-consumer proposition by integrating virtual prepaid cards linked to the user's account, which allow the user to pay in installments at any merchant online.[5]

Some of the most prominent BNPL players are also developing integrated platforms that offer shopping, payments, financing, and banking products in a single platform. These providers seek to engage more consumers through their entire journey, supporting various customer activities and gaining visibility and control of a more significant portion of the customer journey. In doing so, they are restlessly building scale and engagement to become a "super app."[6] For example, Affirm has launched a savings account feature through a partnership with Cross River Bank that allows customers to earn up to a 1.30% annual percentage yield, with no minimums or fees.[7] Meanwhile, Klarna has expanded its operations beyond BNPL solutions with the launch of new products and services, including a rewards program, Vibe, which allows customers to rack up loyalty points and discounts by using Klarna's BNPL offering,[8] a sub-brand

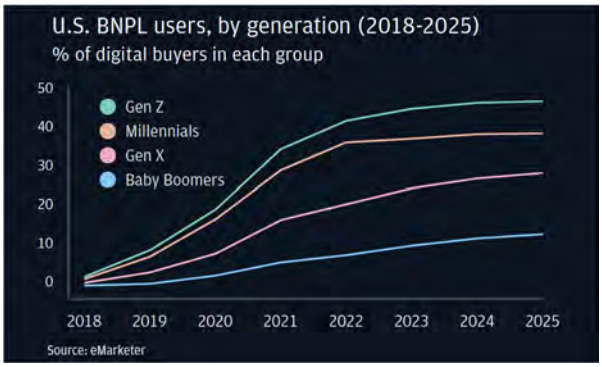
[4] See, J.P. Morgan, Payments are Eating the World, J.P. Morgan Report (2021), p. 22. See, also, McKinsey & Company, Buy now, pay later: Five business models to compete, McKinsey Report (July 29, 2021); Deloitte and Mambu, The Deloitte and Mambu Guide to Buy Now, Pay Later, How BNPL can unlock growth for banks and retailers, Deloitte and Mambu Report (2022).
[5] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, Bain & Company Report (2021), pp. 13 and 14.
[6] See, FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, FT Partners Report (September 2021).
[7] See, Affirm, Affirm Introduces High-Yield Savings Account, Affirm Press Release (July 2020); Rachel Green, Affirm has launched a high-yield savings account, positioning itself to compete with neobanks, Business Insider (June 10, 2020); Finextra, Affirm launches savings account, Finextra (June 9, 2020).
[8] See, Klarna, Klarna launches Vibe: The first buy now, pay later shopper loyalty program, Klarna Press Release (June 9, 2020); Klarna, Klarna's rewards club Vibe surpasses 2 million US members, Klarna Blog (October 7, 2021).

and business unit, Klarna Kosma, which aims to harness the rapid growth of Klarna's open banking platform,[9] as well as a no-interest, no late fees physical card in the United Kingdom.[10]

While some BNPL providers operate independently, others partner with banks. In these instances, a company may purchase the loans back from a bank or sell them to third parties.

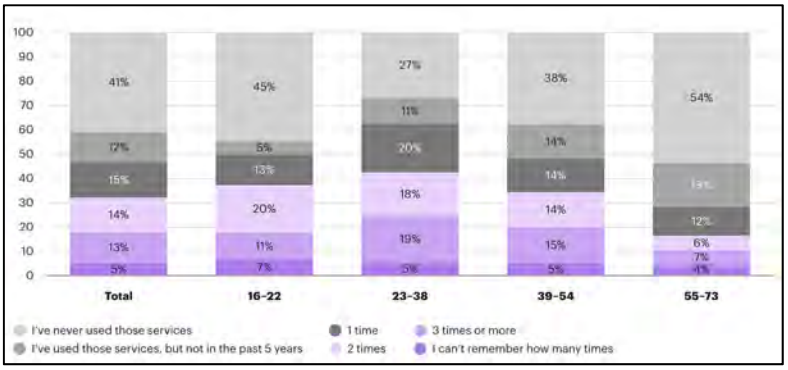
Industry researchers have found that the rise of BNPL solutions has been particularly pronounced among younger cohorts. BNPL is especially attractive to Millennials and Generation Z, who currently represent the vast majority of BNPL users and are driving significant growth in the BNPL market. For example, the average customers for Klarna, Afterpay, and Zip are in their early 30s.[11]

U.S. BNPL users, by generation (2018-2025). % of digital buyers in each group



Source: eMarketer; J.P. Morgan, Payments are Eating the World, cit., p. 22.

Use of POS Credit Services by Age



Source: Kearney, Credit uncrunched: why banks and retailers must develop more PoS credit services, Kearney Insights (2020).

Younger generations are attracted to digital-first services and increasingly embrace BNPL solutions as they look for more transparent, flexible, and inclusive ways to pay than traditional credit and interest-

[9] See, Klarna, Klarna launches 'Klarna Kosma' sub-brand and business unit to harness rapid growth of Open Banking platform, Klarna Press Release (March 31, 2022).
[10] See, e.g., Klarna, The Klarna card is here: we're launching a no interest, no late fees physical card in the UK, Klarna Blog (January 26, 2022); Finextra, Klarna launches physical BNPL card in the UK, Finextra (January 26, 2022); John Reynolds, Klarna Card "makes sense" amid feverish competition in buy now, pay later sector, Altfi (February 16, 2022).
[11] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', CB Insights Report (2021), p. 13. See, also, Afterpay, Millennials and Gen Z in the US: Next Gen Index, Afterpay Report (2020); Afterpay, Millennials and Gen Z in the UK: Next Gen Index, Afterpay Report (2020); Capgemini, World Payments Report 2021, Capgemini Research Institute Report (2021).

bearing options. A recent study estimates that more than 60% of Millennials have used POS credit services and installment payment options, and 42% have used them more than once.[12]

Further studies of BNPL usage in the United States indicate that: the percentage of Generation Z using BNPL solutions significantly increased from 6% in 2019 to 36% in 2021; Millennials' usage of BNPL solutions more than doubled from 17% in 2019 to 41% in 2021; Gen X adoption more than tripled from 9% in 2019 to 30% in 2021; and Boomers increased their usage of BNPL solutions from 1% in 2019 to 18% in 2021.[13]

As BNPL solutions typically involve only 'soft' credit checks and don't come with 'hidden fees,' younger consumers have progressively taken on BNPL solutions as a natural alternative to traditional credit that gives them more flexibility and control. Many of these customers are shifting away from using high-interest credit cards and other traditional credit solutions, while others don't have credit cards at all as they prefer to avoid using them or lack the credit history necessary to be approved for credit cards.[14]

Although BNPL is popular with young users, it has gradually broadened its appeal across other age demographics. For example, a recent survey shows significant BNPL adoption for users in the late 40s and early 50s in the United Kingdom. Some of these users also have access to credit cards, thus suggesting significant penetration among people with prime and near-prime credit profiles. The survey further indicates that BNPL usage in the United Kingdom has been relatively consistent across household income levels and for men and women.[15] Similarly, recent studies of the U.S. BNPL market show that BNPL adoption across higher-credit customers is rapidly increasing as the credit mix is influenced by more premium merchants starting to offer BNPL financing at check-out.[16]

While the customer population is growing and diversifying, BNPL users are also increasing the frequency of their BNPL transactions.[17] Recent studies show that the BNPL purchase frequency for key providers like Afterpay, Klarna, Quadpay (acquired by Zip), and Sezzle (acquired by Zip) is on the rise, growing 67% from 3 purchases per customer on average per month in June 2019 to 5 purchases on average per month during the same period in 2020.[18]

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[12] See, Kearney, Credit uncrunched: why banks and retailers must develop more PoS credit services, cit.

[13] See, Ron Shevlin, Buy Now, Pay Later: The "New" Payments Trend Generating $100 Billion In Sales, Forbes (September 7, 2021).

[14] See, e.g., 1:1 FS Fintech Insider, After Dark Debate - Buy Now Pay Later, 1:1 FS Insights (December 18, 2020); Capital Economics, Buy Now, Pay Later (BNPL) and the new economic landscape, Capital Economics Report (Commissioned by Klarna) (March 2021), pp. 17 – 19; Accenture, The Economic Impact of Buy Now, Pay Later in the US, Accenture Report (Commissioned by Afterpay) (September 2021), pp. 10 and 11; Maurie Backman, Study: Buy Now, Pay Later Services Continue Explosive Growth, The Ascent Insights (March 22, 2021); James Eyers, Credit cards slump as customers shift to buy now, pay later, Financial Review (May 12, 2020); Ted Rossman, Do young adults want credit cards?, Bankrate (March 4, 2022); McKinsey & Company, Global payments 2021: Transformation amid turbulent undercurrents, McKinsey Insights (October 7, 2021); Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, Worldpay Report (2022), p. 7 (noting "[e]-commerce payment preferences continue to shift away from cash and credit cards towards digital wallets and buy now, pay later (BNPL). Contributing factors in credit cards' declining share include the rise of alternative payment methods, volume shifting to credit- and debit-linked digital wallets, consumers opting for interest-free credit in the form of BNPL and credit-centric verticals like travel still recovering from pandemic impacts."); Divido, The Global Lending Report, Divido Report (2019).

[15] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 20 - 24. See also, PYMNTS, BNPL Expands 'Next Gen' Label; Aims Across Demographics, PYMNTS (April 9, 2021); Which?, Under Pressure: Who Uses BNPL?, Which? Policy Report (May 2021); Which?, How to spot a "buy now, pay later" shopper, Which? Technical Report (May 2021); Which?, Buy now pay later, Understanding and addressing the risks to consumers, Which? Policy Report (January 2022); Which?, Buy now pay later, Understanding and addressing the risks to consumers, Which? Policy Report Methodology (January 2022)

[16] See, McKinsey & Company, Buy now, pay later: Five business models to compete, cit.

[17] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 16.

[18] See, Cardify, Convenience, Debt, and Novelty: Analyzing BNPL Consumer Data, Cardify Report (September 8, 2021).

Although to date, BNPL payment solutions have been highly successful with purchases in key segments like apparel, electronics, beauty, and homeware, the rapid increase in purchase frequency discussed above suggests that BNPL may have the potential to expand into new segments markets, including healthcare, hospitality, travel and entertainment and to capture a relevant share of bigger-ticket purchases traditionally made with credit cards.[19] An example of BNPL providers moving in this direction is U.S.-based Uplift, which has partnered with various airline companies, including Lufthansa, Southwest, and United Airlines, to offer a BNPL option for travel purchases.

In addition, BNPL payment solutions are progressively broadening their geographic reach. BNPL penetration rates represent c. 25% of global e-commerce markets and are primarily led by early adopters, thus suggesting significant growth potential. The BNPL share of e-commerce penetration tends to be higher in Europe (particularly in Sweden (24%)) compared to the United Kingdom (3%) and the United States (1%).[20] After disrupting e-commerce-heavy regions like the United States, Europe, the United Kingdom, and Australia, the BNPL market is rapidly emerging across new geographies, including Latin America, Africa, and the Middle East.[21]

As indicated above, BNPL arrangements tie payment back to the consumer's credit or debit card. This structure facilitates a smooth user experience and helps strengthen the brand recognition of BNPL companies and accelerate BNPL usage. Some BNPL providers also allow consumers to apply for a virtual card for the BNPL purchase, and in some cases enable consumers to add the virtual card to their digital wallet (e.g., Apple Wallet, Google Wallet, Samsung Pay), thus enabling consumers to shop anywhere in installments regardless of whether the merchant offers a BNPL option.

Increased convergence between traditional POS financing and BNPL solutions is emerging as both move toward multi-product and omnichannel offerings.[22] Although the BNPL industry has significantly benefited from increased e-commerce and online penetration, and BNPL solutions are most visible in online purchases, the offline market still represents an attractive proposition. In light of this, some BNPL providers (including Affirm, Klarna, Afterpay, and Quadpay (acquired by Zip)) are finding ways to support merchants with in-person sales and are becoming more prominent in both online and offline shopping. These BNPL players have built in-store payment solutions and have integrated with the merchants' in-store POS systems, thus allowing shoppers to pay using a QR code or bar code and facilitating a better omnichannel experience. Some BNPL firms like Laybuy and Zilch have made BNPL solutions available for in-person purchases by offering virtual cards that consumers can utilize to delay payment on in-store purchases.[23] Other BNPL firms are expanding their offerings with physical cards that make it easy to use BNPL on in-store purchases. For instance, Klarna has launched in Sweden, Germany, and the United Kingdom and has opened a waitlist in the United States for Klarna Card, a physical Visa card that allows cardholders to pay for any in-store or online purchases in installments

[19] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 19.
[20] See, Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit.
[21] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 19.
[22] See, FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., p. 6.
[23] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 14.

over time.[24] Similarly, Affirm offers Affirm Debit+ Card, a physical card linked to an existing checking account that can be used to split any eligible online or in-store purchase within 24 hours of the transaction into four interest-free payments due every two weeks.[25]

1.2 The Pros and Cons of BNPL

1.2.1 BNPL's Key Benefits

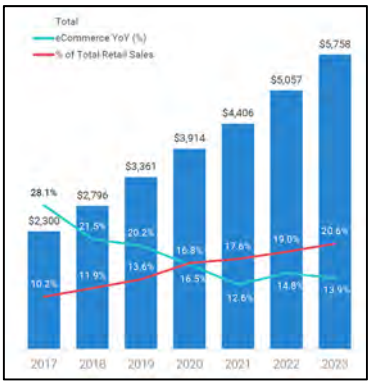
BNPL payment solutions aren't a new phenomenon: the concept of 0% finance and loans at check-out have existed for decades, and some of the leading BNPL players like Klarna have been operating since the early 2000s. However, the BNPL market has gained unprecedented momentum and has experienced extraordinary growth, catalyzed in part by the Covid-19 pandemic, over the past two years.[26]

The Covid-19 pandemic has significantly impacted everyday life and entire industries of the world's economies. The measures enforced to control the Covid-19 pandemic have triggered massive economic consequences, accelerated the shift to digital solutions, and radically reshaped finance and banking services. In turn, rapid structural changes in the financial and banking industry have created new opportunities.[27]

Physical distancing, travel bans, and lockdown restrictions on mobility have contributed to supercharging e-commerce penetration and volumes and have caused omnichannel shopping activity to accelerate rapidly. Meanwhile, the economic uncertainty prompted by the Covid-19 pandemic has gradually shifted consumers away from credit cards and traditional lending and payment products toward more short-term payment plans, low-cost or free services with convenient, intuitive, and seamless digital experiences.[28]

BNPL companies have proven very successful throughout these changes. As illustrated below, strong growth in e-commerce and increased digitalization of banking and financial services accelerated by the Covid-19 pandemic have been vital drivers giving rise to BNPL and other alternative payment methods.

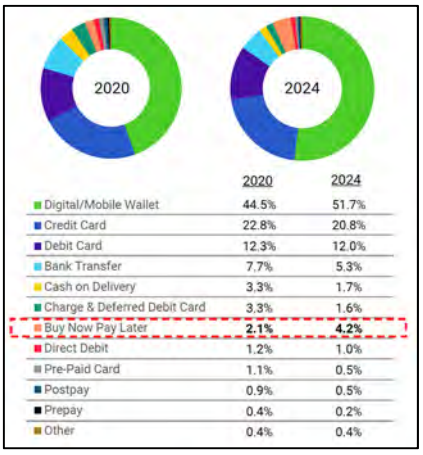
Size of the Retail eCommerce Market ($ in trillion)



Source: eMarketer May 2020; FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit with Convenience, Data & eCommerce, cit., p. 20.

[24] See, Klarna, The Klarna card is here: we're launching a no interest, no late fees physical card in the UK, Klarna Blog (January 26, 2022); Klarna, Klarna opens waitlist for highly anticipated Klarna Card to US consumers, Klarna Blog (February 17, 2022).
[25] See, Affirm, Affirm Announces Plans For Its First Card with Access to Buy Now, Pay Later Functionality, Affirm Press Release (February 25, 2021).
[26] See, Cardify, COVID-19 and the surge of "buy now, pay later", Cardify Report (July 29, 2020).
[27] See, e.g., 1:1 FS, How the COVID-19 pandemic will accelerate digital financial services, 1:1 FS Report (2020); McKinsey & Company, Global payments 2021: Transformation amid turbulent undercurrents, cit.
[28] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit. p. 2.

Global eCommerce Payment Methods

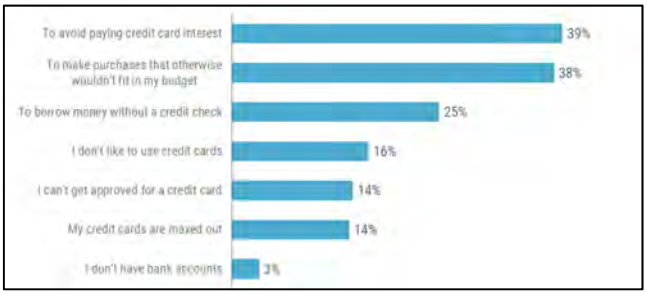


	2020	2024
Digital/Mobile Wallet	44.5%	51.7%
Credit Card	22.8%	20.8%
Debit Card	12.3%	12.0%
Bank Transfer	7.7%	5.3%
Cash on Delivery	3.3%	1.7%
Charge & Deferred Debit Card	3.3%	1.6%
Buy Now Pay Later	2.1%	4.2%
Direct Debit	1.2%	1.0%
Pre-Paid Card	1.1%	0.5%
Postpay	0.9%	0.5%
Prepay	0.4%	0.2%
Other	0.4%	0.4%

Source: Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit; FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit with Convenience, Data & eCommerce, cit., p. 20.

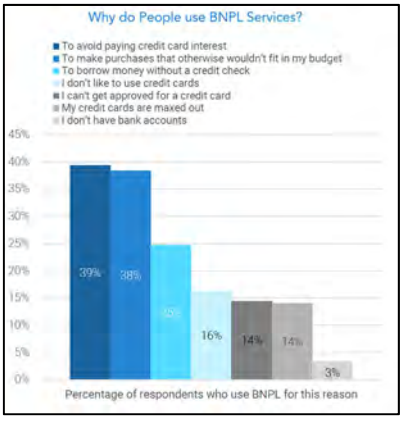
Customers have increasingly looked at BNPL solutions as a seamless and flexible purchasing experience, enabling them to defer payments interest-free. Recent surveys have identified a wide range of user benefits, with the benefits discussed below being the most cited reasons by consumers for using BNPL solutions.[29]

Reasons shoppers use BNPL



Source: The Ascent Survey; CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 13.

Why do People Use BNPL Services?



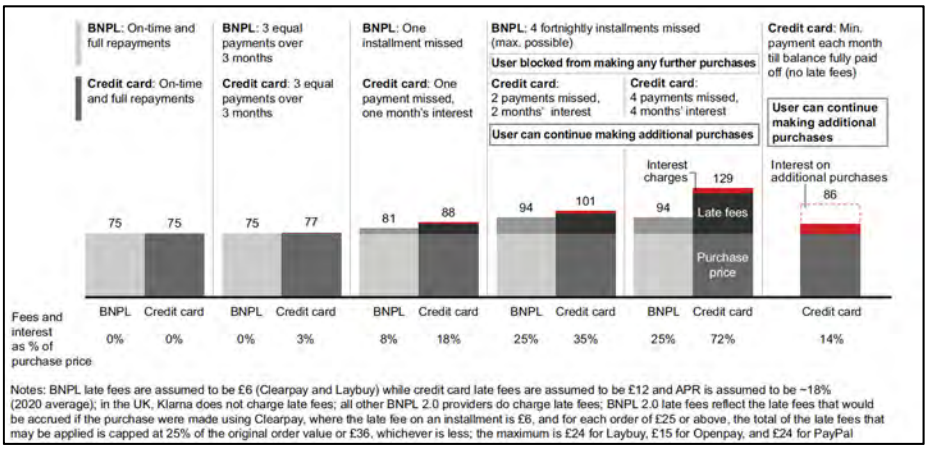
Source: FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit with Convenience, Data & eCommerce, cit., p. 23.

[29] See, e.g., CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., pp. 6, 11 - 13; Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 29 - 50

BNPL products can help customers increase financial flexibility and alleviate budget stress and financial pressure by spreading or delaying payments for their purchasers. When they operate as promoted, BNPL solutions can benefit customers by helping them manage their cash flow, often at a lower cost and with great flexibility relative to traditional financial products and services.

Despite differences in operating models that make like-for-like comparisons difficult, recent studies show that BNPL is a more cost-effective method of borrowing than traditional forms of credit.[30]

Illustrative comparison of fees and interest on a single £75 purchase (£)



Source: Bank of England data; Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 31.

BNPL providers apply little or no interest, and when they charge late payment fees, these fees tend to be lower than those charged by credit cards or banks in the case of delinquency or default. In addition, BNPL interest and fee structures tend to create the right incentivizes for BNPL providers to deter misuse and not allow unpaid balances or rolled-over debt, which would otherwise become expensive long-term debt and keep customers in a vicious cycle of debt. BNPL providers tend to encourage greater usage but with timely repayments, for instance by barring users from making further purchases if they miss payments, thus preventing them from incurring additional debt.[31]

Moreover, BNPL help make an increasingly wide range of goods and services more affordable to consumers. By using BNPL solutions, consumers can unlock purchasing power and make purchases where they couldn't otherwise afford to pay the full price up-front.[32]

The overall customer journey, convenience, and ease of use are other key drivers of BNPL adoption. BNPL providers offer intuitive navigation and workflows, coupled with instant credit decisions and easy-to-use interfaces, which help create an overall experience that resonates with customers. Excellent customer service, reduced friction, and useful features (including direct debits, in-app reminders of

[30] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 30 and 31.
[31] See, e.g., Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 30; 1:1 FS, Buy Now Pay Later: Love it or hate it, you can't ignore it, 1:1 FS Insights (November 26, 2020); Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., pp. 18 – 20; Paypal, Excitement for buy now, pay later options grows as younger consumers seek flexible, no-interest payment options, Paypal Insights (January 25, 2022);, Julian Alcazar and Terri Bradford, The Appeal and Proliferation of Buy Now, Pay Later: Consumer and Merchant Perspectives, Federal Reserve Bank of Kansas City Payments System Research Briefing (November 10, 2021).
[32] See, e.g., Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 32; Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., pp. 9 and 10, 14 and 15; PYMNTS, BNPL Provides Flexibility and Buying Power to Younger Consumers, PYMNTS (March 1, 2022).

upcoming payments, linking transactions and tracking BNPL shopping, and temporarily snoozing payments) also help customers manage BNPL debt in a convenient, simple, and transparent way.[33]

In addition, BNPL solutions are increasingly seen as a source of credit that is cost-effective and easier to manage than alternatives. Users often opt-in for credit products from BNPL providers because of the improved chance of getting approved and the better and seamless user lending experience that the BNPL providers can deliver. BNPL transactions generally involve only a 'soft' credit check and a simplified approval process, with no 'hard' credit checks or traditional underwriting. Access to alternative, enhanced sources of data and better insights are enabling important changes in how users get approved and charged for credit by BNPL providers. Machine learning and artificial intelligence, among others, help BNPL providers harness, process, and analyze large sets of data to build robust credit decisioning systems and risk models, which empower them to reach new consumers, better understand their needs, and then approve and offer credit instantaneously. For example, Affirm provides unsecured loans (typically originated through partnerships with chartered industrial banks like Cross River Bank and Celtic Bank) and utilizes a proprietary credit underwriting model that reportedly approves more customers on average than comparable competitor products.[34]

Related to the above, BNPL has the potential to improve access to credit for consumers with subprime credit histories or those who are underbanked and underserved and have had traditionally limited access to it.[35]

Customers are also progressively looking at BNPL solutions as a preferred payment option to effectively manage trial periods of their purchases, reduce returns-related friction, and remove the associated risks. Many consumers use BNPL to try purchases before being charged, and if they decide to return an item, they simply log on to their BNPL account and halt installments. Several merchants are offering free returns policies, as they envisage that the overall sales increase will be higher than the cost of managing the returns.[36]

The benefits described above, among others, have combined to make BNPL a very compelling proposition and have contributed to the relatively high levels of customer satisfaction with BNPL solutions, recording an average Net Promoter Score ("NPS") of 30 (on a −100 to 100 scale), which is a very positive result when compared with the NPS of other payment and credit products.[37]

While BNPL payment options have become popular among customers, they have also gained increased attention from merchants. With in-store shopping traffic at historically low levels due in large part to the Covid-19 pandemic, merchants have rapidly embraced digital technology and turned to BNPL solutions to quickly attract and retain customers online.[38]

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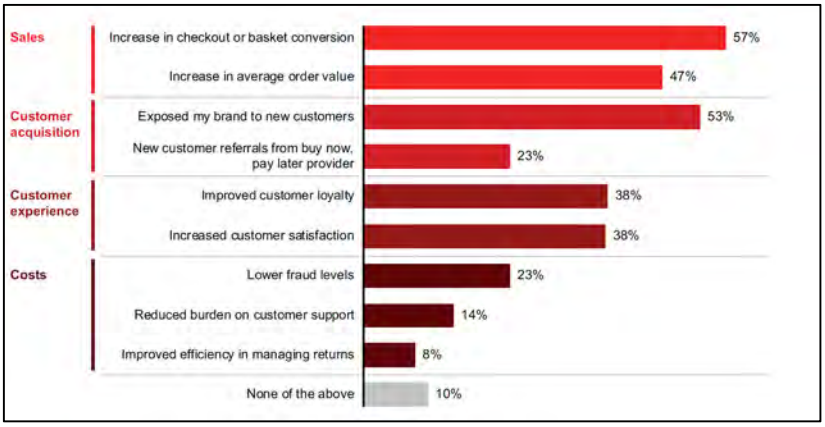
[33] See, e.g., Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 34 and 35; 1:1 FS, What next for the BNPL phenomenon?, 1:1 FS Insights (October 11, 2021); 1:1 FS, Buy Now Pay Later: Love it or hate it, you can't ignore it, cit.; Capital Economics, Buy Now, Pay Later (BNPL) and the new economic landscape, cit., pp. 32 and 33.
[34] See, Affirm, 2021 Annual Report.
[35] See, e.g., Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., pp. 22-23; McKinsey & Company, Buy now, pay later: Five business models to compete, cit.; Liz Pagel, BankThink Buy now/pay later could help young consumers build credit histories, American Banker (March 9, 2022).
[36] See, 1:1 FS, Buy Now Pay Later: Love it or hate it, you can't ignore it, cit.
[37] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 10.
[38] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., pp. 6, 11-13.

From large retailers and well-established brands to small and medium-size sellers, the number of merchants using BNPL is rapidly increasing. The benefits of integrating BNPL solutions for merchants extend well beyond responding to consumer preferences, and are apparent regardless of merchant size, with large and small merchants seeing considerable improvement in business metrics across four main categories - sales, customer acquisition, customer experience, and costs.[39]

Merchants reap many benefits from BNPL



Source: Bain survey of UK merchants (n = 104); Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 37.

In today's challenging economic and retail environment, merchants are increasingly looking for trusted ways to help drive key revenue and growth metrics while optimizing costs. BNPL has demonstrated to be a critical value proposition for merchants by helping them boost average order values (AOVs) and lift purchase rates, both key revenue drivers.[40] For instance, PayPal claims to raise AOVs by up to 56%,[41] while Affirm reports a 85% increase in AOVs for merchants.[42]

In exchange for merchant fees that are often higher than the fees usually charged by Visa and Mastercard, BNPL companies seek to drive increased check-out or basket conversions and repeat purchases, while also lowering user acquisition costs. For example, Klarna reports between 25-30% increased conversion at check-out when BNPL is an option, while Affirm claims businesses can achieve a 20% boost in repeat purchases.[43]

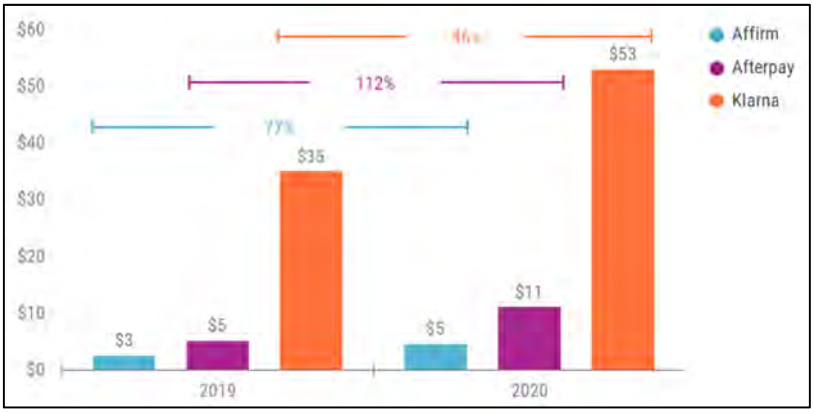
A recent survey of 1,051 U.S. merchants by Zip indicates that offering BNPL payment solutions to customers can help increase sales conversion rates and sales and deliver a better customer experience.[44] A further report published by Accenture (commissioned by Afterpay) notes that Afterpay reported $8.2 billion in total sales for 26,000 US merchants in 2021,[45] with U.S. merchants deriving c. $4.5bn in net benefits from Afterpay through incremental sales and cost efficiencies. According to the report, in 2021,

[39] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 37.
[40] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., pp. 8 and 9; PYMNTS, Deep Dive: How Buy Now Pay Later Is Revitalizing Retail and the Economy, PYMNTS (November 10, 2021).
[41] See, PayPal.com (Business, Enterprise – Buy Now Pay Later).
[42] See, Affirm.com (Business, Solutions – Considerations).
[43] See, Affirm, Why a pay-over-time solution is pivotal to your growth strategy, Affirm Blog (October 6, 2020).
[44] See, Zip, Is 2021 the Year of BNPL? 6 Facts You Need to Know About This Payment Method, Zip Insights (June 10, 2021).
[45] See, Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., pp. 25 – 37.

U.S. merchants partnering with Afterpay achieved a 17% increase in basket sizes, a 16% increase in web traffic, 13% more new customers (with a high frequency of repeat purchasing), and a 12% sale uplift.[46]

Key BNPL players have also reported significant increases in gross merchandise value (GMV), a measure of total merchant sales. Among them, Klarna has taken the lead by growing its GMV by 46% from $35 billion in 2019 to $53 billion in 2020,[47] while Afterpay has experienced the most accelerated growth after reporting a 112% increase in GMV year-over-year.[48]

BNPL players provide merchants with increased GMV
Gross Merchandise Value (GMV) in $ billion and growth rate (%), 2019 - 2020



Source: Company filings; CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., 21.

In addition, BNPL features are increasingly playing a key role in merchants' growth plans and customer acquisition and retention strategies. BNPL check-out options are incorporated into merchant mobile and online sites via APIs, which help remove barriers to purchase and deliver seamless check-out experiences without requiring significant developer resources. Leading BNPL providers are also increasingly launching loyalty programs, optimizing payment flows and customer journeys, and building unique relationships with customers with the aim of becoming a centralized shopping destination. In doing so, BNPL providers can help merchants capture and retain a larger user base, aggregate customer demand, and increase cross-sell opportunities.[49] In addition, merchants can leverage BNPL providers' trusted online shop directories to increase exposure to new customers, display their brand and offerings to new customers through co-marketing activities, and track the direct referral of customers from BNPL providers.[50] As more BNPL providers develop platforms and aggregators where customers can search and buy e-commerce items, merchants have also started using them as marketing channels to offer discounts and promotions.[51]

Leading BNPL players invest heavily in brand marketing to create a halo of trust around their brand, which they then leverage to drive adoption.[52] Given the ongoing race to sign up the largest and most prominent merchants, BNPL providers are competing heavily on price and marketing support promised

[46] Ibidem.
[47] See, Klarna, Full Year Results 2021.
[48] See, PRNewswire, Afterpay Reports Record Sales of $10B in First Half 2021, PRNewswire (February 25, 2021).
[49] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., pp. 8 and 9, 21.
[50] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 2, 38 – 40.
[51] Id., p. 34.
[52] See, 1:1 FS Fintech Insider, After Dark Debate - Buy Now Pay Later, cit.

to retailers. The resulting price compression is partially offset by offering merchants affiliate marketing services, where merchants typically pay 4% to 12% of the transacted amount if the customer has landed at the merchant's website from within the BNPL provider's app or website.

Recent data show a strong preference by mid-size merchants on customer acquisition over increased cart conversion and increased average order value across categories, which drives their willingness to pay more for affiliate marketing than for financing.[53] Interestingly, a recent survey by Accenture (commissioned by Affirm) indicates that merchants using BNPL solutions have enjoyed 13% more new customers.[54]

The availability of BNPL payment solutions across a wide range of e-commerce websites has propelled BNPL usage. The convenient nature and use of BNPL checkout options add to the customer experience, with several merchants experiencing a significant rise in customer satisfaction and loyalty. At checkout, customers can easily see the identity of the BNPL providers and rely on their payment methods and financing options. Well-known and trustworthy BNPL solutions at checkout can lend credibility and make shoppers more likely to trust smaller or newer merchants that are still building their brand and trust with customers online.[55]

In addition, some merchants offering BNPL payment solutions have reported relevant cost-reduction benefits, mainly driven by reduced fraud levels, improved customer support, and more efficient returns processes.[56]

Importantly, BNPL providers can also generate powerful insights and provide merchant partners with valuable data on target customer segments and the types of products customers prefer (including past purchases, browsing time, items viewed and saved, and social sharing), which merchants can then leverage to understand customer behavior better and tailor their offerings to meet customer needs.[57]

1.2.2 BNPL's Main Risks and Challenges

As with other forms of credit, BNPL comes with certain risks which must be carefully considered and managed, including the following.

As the BNPL industry gains momentum, concerns have arisen that by accepting BNPL 'one-click' interest-free loans, users may not fully appreciate that they are effectively buying credit products and may, therefore, not apply the same level of scrutiny as they would otherwise do on traditional forms of credit. This concern is amplified by complex and lengthy terms and conditions utilized by certain BNPL firms,[58] and the fact that certain disclosure requirements otherwise applicable to traditional forms of

[53] See, McKinsey & Company, Buy now, pay later: Five business models to compete, cit.
[54] See Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit.
[55] See, e.g., Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 10; Capital Economics, Buy Now, Pay Later (BNPL) and the new economic landscape, cit., p. 33.
[56] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 39.
[57] Id., p. 42; See, also, PYMNTS, Deep Dive: How Partnerships With BNPL Providers Can Help Merchants Elevate Their Marketing Strategies and Data Insights, PYMNTS (September 8, 2021).
[58] See, e.g., NerdWallet, Challenging Reads – Understanding Buy Now, Pay Later T&Cs, NerdWallet Insights (April 7, 2021) (a study of the terms and condition (T&Cs) of popular BNPL apps by NerdWallet finds that these T&Cs can take up to an hour to read and important information about financial risks are often buried in the documents, with unclear wording and complex writing style).

credit do not currently apply to BNPL products, thus creating the risk that consumers may not fully understand the terms of the BNPL products before using them. As a related concern, recent data have highlighted the lack of customer education on responsible BNPL spending and the resulting need to create a better environment to reduce the risk of irresponsible usage and encourage customers to utilize BNPL solutions sustainably.[59]

The simplicity and speed of paying with BNPL solutions and some consumers' implicit (incorrect) assumption that safeguards are in place and that BNPL products are regulated appear to contribute to consumer misunderstanding. Because BNPL services can be easily accessed and utilized, there's a risk that users may intentionally or inadvertently overuse BNPL solutions across multiple providers and rack up a large amount of unaffordable debt.[60]

Consumer advocates have also raised concerns over the potential of BNPL solutions to create unsustainable levels of debt. BNPL lenders do not typically perform 'hard' credit checks, and only conduct a 'soft' credit pull on customers. This creates the risk that BNPL providers may not adequately assess whether a customer can pay off the loan and that users (particularly vulnerable customers who may be more prone to irresponsible spending) may be induced to take on more debt than they can actually afford and then be hit with a series of fees for falling into arrears.[61] Interestingly, a recent survey conducted by Qualtrics (on behalf of Credit Karma) shows that a third of U.S. survey respondents who've used BNPL solutions have missed BNPL payments as of December 2020.[62]

Moreover, existing data-sharing mechanisms and credit-scoring models have been designed for traditional credit products and longer-term borrowing and usually work well for an up-front credit check toward larger credit limits which is underwritten only once. On the contrary, traditional data-sharing and credit mechanisms and models are less suitable for BNPL solutions, where customers typically take small low-value amounts of credit with higher frequency. While certain credit reference agencies ("CRAs") have started working with BNPL providers to improve existing processes and models, several BNPL companies have also developed innovative underwriting approaches and have been aggregating their

[59] See, Which?, Buy now pay later, Understanding and addressing the risks to consumers, cit., pp. 18 – 26; Zilch, Survey: BNPL Has Consumers Confused, 43% Believe BNPL Companies Make Money On the Interest They Collect, Zilch Survey (March 30, 2022) (noting that although BNPL is growing in popularity among consumers with 31% of consumers having used the service, there are still key misconceptions, confusion and a prevalent lack of understanding of how BNPL companies operate, compete with traditional credit card companies, and serve consumers).

[60] Ibidem.

[61] See, e.g., Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 48 – 50; Siddharth Venkataramakrishnan, 'Buy now pay later' boom fuels consumer debt concerns as transactions soar, Financial Times (February 12, 2022); Weizhen Tan, The 'buy now, pay later' trend could be the next hidden source of consumer debt, analysts warn, CNBC (August 10, 2021); Penelope Wang, The Hidden Risks of Buy-Now, Pay-Later Plans, Consumer Reports (February 14, 2021); Charlotte Gifford, Think less, spend more: how 'buy now, pay later' firms encourage impulse buying, Which? (December 11, 2020); John Adams, How regulators worldwide aim to rein in buy now/pay later, American Banker (November 4, 2021); Sophie Church, 'I thought I was being money savvy, but ended up £10k in debt': The true cost of Buy Now Pay Later schemes', Metro.co.uk (March 27, 2022).

[62] See, Credit Karma, 72% of Americans saw their credit scores drop after missing a 'buy now, pay later' payment, survey finds, Credit Karma Insights (February 8, 2021) (noting "[a] joint Credit Karma/Qualtrics survey has found that 42% of Americans have used some sort of "buy now, pay later" service … Of survey respondents who've used "buy now, pay later" options, 38% reported they've missed at least one payment."); Credit Karma, Buy now pay later surges throughout pandemic, consumers' credit takes a hit, Credit Karma Insights (September 9, 2021) (noting ("[a]ccording to a survey conducted by Qualtrics on behalf of Credit Karma, 44% of Americans have used buy now, pay later products to acquire an item they needed, up slightly from December 2020 … 34% of those who have used BNPL services, have fallen behind on one or more payments.").

user data to build proprietary credit information and assessment models, which enable them to measure spending limits and to underwrite credit in real-time.[63]

Related to the above, further concerns have been raised about the lack of mandatory reporting to a regulatory body and credit bureaus, as well as the shortfall of data available and the limited consolidated mechanisms for BNPL providers to share data between them and with other lenders, which may contribute to customers debt spiraling across multiple providers. At present, most BNPL companies share data solely on missed payments and defaults and are unable to combine customers' cumulative balances across providers. Various BNPL providers and CRAs are exploring integrations and collaborating to develop scalable solutions and more comprehensive data-sharing mechanisms to address this issue.[64] The required data and infrastructural changes are expected to be significant and may take time to be implemented at scale and consistently across the whole BNPL industry.

As many BNPL providers do not report payments to the credit bureaus, consumers may miss out on important opportunities to build credit, particularly those with a limited credit history and making their BNPL payments on time. By contrast, because BNPL providers report delinquencies to CRAs, consumers who have delayed or missed their BNPL payments may negatively impact their credit score (in addition to being subject to penalties and late fees, where applicable). For example, a recent study indicates that 72% of survey respondents, who have used BNPL solutions and missed a payment, have reported seeing a decline in their credit scores afterward.[65]

Because BNPL solutions may give BNPL companies access to sensitive consumer financial data, data privacy and consumer cybersecurity-related concerns have also increased.[66] Consumers may not fully appreciate how their data are being collected and processed by BNPL providers and may have limited ability to control or correct it. This, in turn, can make it difficult for consumers to protect their privacy, obtain redress for data breaches, or avoid other negative consequences from the misuse of their data.

In addition to the risks highlighted above, concerns have been raised that some of the leading BNPL companies may face significant challenges in securing funding and may have 'unsustainable' high market valuations, despite often being loss-generating operations. Such high valuations may consider expected revenues from sources indirectly related to the traditional BNPL business, including the

[63] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 18 and 19, 43 and 44.

[64] See, e.g., Robin Saks Frankel, How The Big Three Credit Bureaus Are Using Buy Now Pay Later Data, Forbes (March 22, 2022); Yaël Bizouati-Kennedy, Equifax, Experian & TransUnion Want to Add BNPL to Credit Reports, Yahoo! Finance (March 18, 2022); AnnaMaria Andriotis, Equifax to Add More 'Buy Now, Pay Later' Plans to Credit Reports, The Wall Street Journal (December 19, 2021); Lauren Smith, Experian and Equifax to Add BNPL Plans to Credit Files, MoneyExpert (March 9, 2022); Gabriel Zimmer, How to Prepare for Buy-Now-Pay-Later Purchases Showing Up on Credit Reports, The Wall Street Journal (February 28, 2022); Daniel Lanyon, Klarna purchases will soon affect your credit score, AltFi (May 4, 2022); Ryan Browne, 'Buy now, pay later' will soon affect your credit score in the UK, CNBC (May 5, 2022); a16z, Credit reporting for Buy Now, Pay Later (BNPL), Future from a16z Insights (January 27, 2022).

[65] See, Credit Karma, 72% of Americans saw their credit scores drop after missing a 'buy now, pay later' payment, survey finds, cit.

[66] See, Ruston Miles, BankThink Buy now/pay later creates new risks for personal data, American Banker (March 24, 2021); PYMNTS, As Regulators Probe BNPL Practices, Data Privacy and Localization Rules Come Into Play, PYMNTS (March 31, 2022); Nick Green, Data considerations for Buy Now Pay Later offerings, Finextra (October 14, 2021); Nick Green, BNPL data in 2022: What's next for risk models and scores, Finextra (January 18, 2022).

processing of customer data and information on spending patterns and the ability to cross-sell other financial services.[67]

A recent study questions the viability of BNPL as a standalone business.[68] According to the study, BNPL provides an excellent route for scaling and accelerating customer acquisition. However, customer acquisition is all very well only if the businesses have other products and services to which they can direct customers and can monetize through bundled payment pricing. Moreover, the study suggests that the lack of regulation has helped BNPL firms grow rapidly and keep costs down. Still, as tougher regulatory frameworks are expected to be enforced, profit margins may be materially squeezed. Because of these factors, the study anticipates that pure-play BNPL providers may struggle to achieve long-term profitability unless they either evolve their business model or are acquired by a bigger player. Klarna is discussed as an interesting example of a BNPL provider taking the former approach, as it progressively moves towards a 'super-app' model in an effort to diversify its revenue streams and find paths to monetization away from pure-play BNPL. [69]

Related to the above, critics have noted that most BNPL firms have scaled their activities in relatively benign market conditions. The abundance of capital in private markets has created a relatively 'cheap' funding environment for BNPL firms to finance their operations. In addition, record-low interest rates have driven flows into the consumer credit market and have helped BNPL providers offer credit to consumers for no or very low interest while generating significant revenues from merchant fees (and, in some instances, late payment charges). However, these market conditions have rapidly changed in recent months, thus putting increased pressure on BNPL firms, driving up their cost of doing business, and causing some of them to reconsider their growth and expansion plans. Significant uncertainty remains as to the longer-term viability of the business models adopted by certain BNPL providers, which are expected to be increasingly tested due to fluctuations in the quality of credit performance over a cycle, reduced merchant fees, and narrow margins driven by increased competition, interest rate hikes and the anticipated impact of future regulatory reforms.[70] As the macroeconomic environment deteriorates further and public markets are down, BNPL providers are grappling with the prospect of an economic downturn. Some BNPL providers now face increased skepticism from investors and have a much harder time raising money, in some instances at considerably lower valuations and less favorable terms compared to their most recent funding rounds. Even the largest and best-funded BNPL providers have reported large net losses. In response, they are considering (or have already announced) plans to cut their expenses in an effort to extend their runways, are shifting their business away from growth 'at all costs' toward sustainable profitability and are trying to diversify their revenue streams and sources of funding.[71]

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[67] See, e.g., Alex Wilhelm, Here's what your BNPL startup could be worth, TechCrunch (September 14, 2021); Finextra, BNPL – all of this hype for a not-so-profitable business? Finextra (September 15, 2021); Alex Wilhelm, Why Affirm's stock is getting hit, and what the selloff means for the BNPL startup market, TechCrunch (February 11, 2022); Karen Kwok, Klarna's $46 bln price tag endures only in theory, Reuters (May 19, 2022); Ben Dummett and Julie Steinberg, SoftBank-Backed Fintech Giant Klarna Looks for New Funds at Lower Valuation, The Wall Street Journal (May 19, 2022).

[68] See, Jemima Kelly, Is "buy now pay later" a viable business model?, Financial Times (October 7, 2021).

[69] Ibidem.

[70] See, e.g., Lazard Asset Management, How Buy Now, Pay Later Providers Are Disrupting the Payments Ecosystem, Lazard Research and Insights (November 2021); Pierre Suhrcke, BNPL – From Hype to Bubble Bursting, Finextra (May 13, 2022).

[71] See, e.g., Amy O'Brien, Can Klarna and its rivals survive an economic downturn?, Sifted (May 24, 2022); Alex Wilhelm, The BNPL boom may be fading, TechCrunch (May 10, 2022); Richard Milne, Klarna CEO says fintech will focus less on growth and more on 'short-term profitability, Financial Times (May 26, 2022); Richard Milne, Klarna boss puts brave face on buy now, pay

Lastly, in recent months inflation has increased to reach its highest rates and the costs of living have risen dramatically, with the prices of non-discretionary items such as food and fuel rising the fastest. This has caused a slowdown in consumer spending, which contributes to reducing BNPL-related transactions. On the other hand, rising inflation has also caused the least affluent households' purchasing power to fall thus forcing more people to turn to BNPL or similar forms of credit to pay for basic goods and services when they can't immediately afford purchases. As more customers lean into BNPL products to cover essentials, concerns emerge that more individuals may plunge into debt and struggle to pay their debts, and that default rates may sky rock and leave BNPL firms absorbing larger credit losses in the months to come.[72]

1.3 BNPL Market Overview

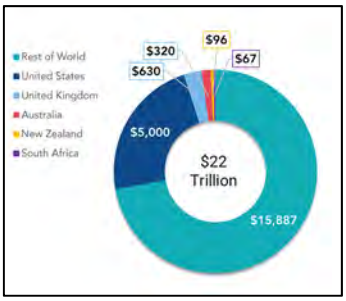
BNPL Market Activity and Trends

Although BNPL currently represents a relatively small portion of the aggregate spending on payment cards (including credit, debit, and prepaid cards), BNPL transactions have been growing at a blistering pace accounting for 2.9% of global e-commerce transaction value in 2021 and projecting to 5.3% share by 2025.[73]

Strong evidence suggests that the BNPL market is at an inflection point and is poised for long-term growth.[74] Recent data show that the global BNPL industry is expected to grow 10-15x its current volume by 2025, reaching $1 trillion in annual gross merchandise volume by some estimates.[75]

In its 2020 Annual Report, Australian BNPL provider Zip estimates that its addressable global market stands at $22 trillion, with the United States comprising roughly 22% of that.

BNPL Global Addressable Market ($ billion)



Source: Zip 2020 Annual Report; FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., p. 24.

later problems, Financial Times (May 27, 2022); Mimi Billing, Klarna lays off 10% of its team amid valuation crunch, Sifted (May 23, 2022); Aisha S. Gani and Ivan Levingston, Klarna Faces Valuation Drop to $30 Billion as Seeks Funding, Bloomberg UK (May 19, 2022); Emily Bary, Affirm stock skids as Upstart anxiety weighs on fintech sector, MarketWatch (May 10, 2022); Sujeet Indap and Imani Moise, Affirm struggles to convince investors of fintech bona fides, Financial Times (May 11, 2022).

[72] See, e.g., Citizens Advice, One in 12 now using Buy Now Pay Later to cover essentials, Citizens Advice, Citizens Advice Press Release (March 11, 2022); Madeleine Taylor, Cost-of-living squeeze sparks concerns over buy-now-pay-later, Investors' Chronicle (April 7, 2022).

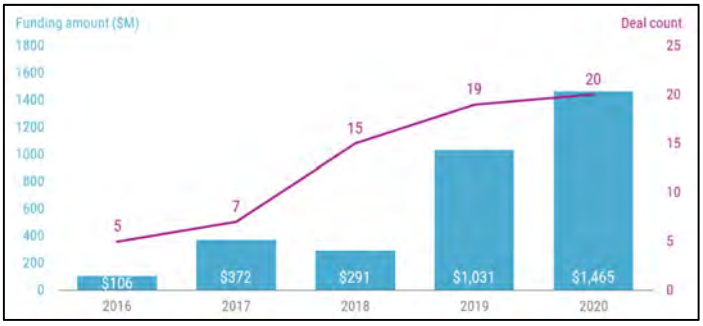
[73] See, Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit., p. 7.

[74] See, e.g., Cardify, COVID-19 and the surge of "buy now, pay later", cit.; Kate Fitzgerald, Missed payments don't faze new buy now/pay later lenders, American Banker (September 17, 2021); Morgan Stanley, "Buy Now, Pay Later": Banking on Global Financial Innovation, Morgan Stanley Research (November 11, 2021) (noting that "BNPL currently represents only a portion of overall global online purchases—2% in the U.S., 7% in Europe, 10% in Australia—but it's growing. And [Morgan Stanley's] analysts say that the potential growth from the generational shift to this innovation cannot be underestimated.").

[75] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 3.

Significant capital has flown into the BNPL market over the past few years, with high-growth BNPL players raising a record-high $1.5 billion in 2020 across 20 deals (a 42% increase from 2019).[76]

Disclosed BNPL equity funding deals ($ million), 2016 - 2020



Source: CB Insights.

Institutional and corporate venture investors have shown an increased appetite for BNPL, and are continuing to pour funds into BNPL companies, as they anticipate more upside in light of the increased popularity of BNPL solutions across various demographics and geographics and the still relatively low penetration of the product.

The sector has attracted interest from a wide variety of investors

Source: FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., p. 30.

The last two years have also seen a significant increase in public market valuations for most BNPL providers.

Increase in public market valuations for BNPL providers

Source: FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., p. 25.

[76] See, FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., pp. 27 and 28.

In parallel, the BNPL market has been witnessing a flurry of high-profile deal-making, as a number of high-profile companies are entering the space or consolidating their existing position through investments and acquisitions. Increased competition and expansion plans by key BNPL providers are also driving consolidation in the BNPL market.[77] Notable examples include Block (formerly, Square) acquiring Afterpay for $29 billion in an all-stock deal in August 2021,[78] Affirm buying Paybright for a total cash and equity consideration of c. CAD $340 million in January 2021,[79] Zip announcing a definitive agreement to acquire Sezzle in an Australian $491 all-shares deal in February 2022,[80] and Zilch acquiring Nepfin in September 2021.[81]

These trends have partially reverted in recent months, as the macroeconomic environment deteriorates and public markets are down. Some private BNPL firms are now seeking to raise new funds at lower valuations than their previous rounds as they face increased scrutiny by investors, while the public market capitalization and the value of the stocks of certain high profile public BNPL players have been trending down for the most part of 2022.[82]

The U.S. BNPL Market

According to data published by Accenture, BNPL payments are c. 2% of all online retail spending in the United States, and they make up over 12% of all online fashion retail spending. This is equivalent to c. $20.8 billion in 2021, spent by 45 million U.S. consumers.[83] These data suggest that, although BNPL is currently a small portion of the overall U.S. payments system, it is already significant in some key categories and channels.

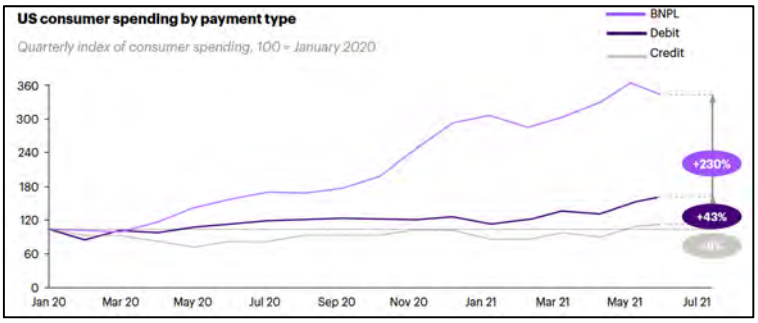
U.S. BNPL market share of payments

Source: Afterpay data; US Census Bureau (2021); Statista (2021); Accenture analysis; Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., p. 12.

[77] See, e.g., Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit., p. 64 (quoting Peter Wickes, FIS general manager, EMEA, Enterprise, expressing the view that "[t]here are now so many companies that offer BNPL services, some form of consolidation in the market feels inevitable … Merchants need help to make decisions about the number of payment methods they actually need to offer. There's no need to offer six BNPL options on their payments page when two will more than suffice … That may well supplement organic growth with acquisition of targeted competitors in local markets, where it's going to take them one or two years to expand."); Sarah Kocianski, The Fintech Briefing: The future of Buy Now Pay Later, Founders Factory (February 24, 2022).
[78] See footnote 3.
[79] See, Affirm, Affirm to Acquire PayBright, One of Canada's Leading Buy-Now-Pay-Later Providers, for CAD $340 Million, Affirm Press Release (December 3, 2020); Affirm, Affirm Completes Acquisition of PayBright, Affirm Press Release (January 4, 2021).
[80] See footnote 2.
[81] See, PR Newswire, Zilch Brings Buy Now Pay Later to the US with Acquisition of Nepfin, PR Newswire (September 2, 2021); Aisling Finn, Zilch makes first acquisition as it looks to expand into the US, Altfi (August 11, 2021); Finextra, Zilch acquires US lender NepFin, Finextra (August 11, 2021).
[82] See footnotes 70 and 71.
[83] See, Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., pp. 11 and 12.

Spending on BNPL has increased rapidly in the United States in the past two years – up 230% since 2020, more than five times the growth rate for spending using debit card (43%) and significantly higher than credit card spend growth (8%).[84]

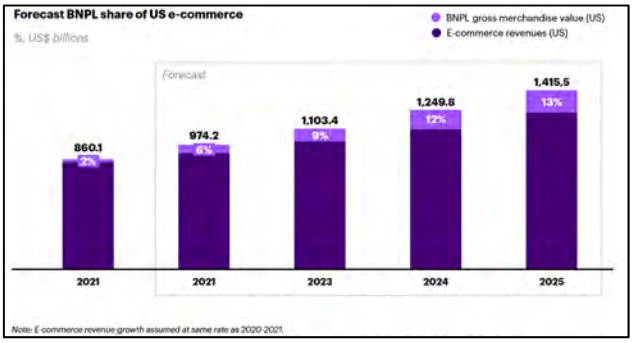
Increase in BNPL spending



Source: Consumer transaction data; Company quarterly release reports; Accenture analysis; Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., p. 12.

This growth is expected to continue, with BNPL transactions reaching 10% of all e-commerce by 2024 as the United States BNPL market catches up to more mature markets like Australia.[85]

Forecast BNPL share of U.S. e-commerce



Source: Credit Suisse (2021), AFRM Q3 Results; US Census Bureau, Estimated Quarterly U.S. Retail Sales (Adjusted1): Total and E-commerce (2021); Research and Markets, United States Buy Now Pay Later Business and Investment Opportunities (2019-2028), Databook (2021); Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit.; Accenture analysis; Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., p. 13.

[84] See, Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit., pp. 12 and 13.

[85] Ibidem. See also Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit., p. 31 (noting "BNPL continued its dramatic global rise, more than doubling its share of North American e-com in 2021, jumping from 1.6% to 3.8% of transaction value. The growth of BNPL shows no signs of abating, projecting to more than double again to 8.5% of regional e-com transaction value by 2025."); Adobe, U.S. Consumers Spent $1.7 Trillion Online During the Pandemic, Rapidly Expanding the Digital Economy, Adobe Report (2022) (noting "[a]s consumers spent more online during the pandemic and looked for new ways to manage their money, BNPL orders between October and November 2020 increased 528% YoY while revenue grew 412% YoY. In recent months, growth has slowed, but demand remained strong: BNPL orders are up 53% YoY while revenue is up 56% YoY").

To date, the U.S. BNPL market has been largely dominated by four key installment players (Afterpay,[86] Klarna,[87] Sezzle (acquired by Zip),[88] and Quadpay (acquired by Zip)),[89] and a key POS lending player (Affirm).[90]

These companies have become incredibly popular over the past two years, with new user growth and transaction volume exploding. Among them, Afterpay holds the largest share of total BNPL transactions (70%), followed by Klarna (12%), Sezzle (10%), and Quadpay (acquired by Zip) (9%). In terms of U.S. user volume, Klarna leads the group with 11 million U.S. customers as of November 2020 (a solid 106% increase from 2019), while Afterpay reported 6.5 million active U.S. accounts (a remarkable 261% increase from 1.8 million in 2019) and Affirm recorded just under 4 million U.S. users.[91]

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[86] Australian based BNPL player Afterpay offers users the ability to pay for their online and in-store purchases in four installments over a six-week periods, with no interest and no additional fees when users pay on time. In the event of missed payments, their accounts are temporarily paused and late fees (capped at 25% of the purchase price) apply. Users can set spending limits and receive payment reminders. In August 2021, Block (formerly, Square) announced that it had agreed to acquire Afterpay for an implied value of approximately $29 billion. The acquisition was completed in January 2022 and aims to further Block's strategic priorities for its existing Square and Cash App ecosystems and to accelerate Afterpay's growth in the U.S. and globally. By joining forces, Block and Afterpay seek to provide a broader platform of new and valuable BNPL capabilities and services to merchants and consumers. On the same day it announced the completion of the acquisition, Block also launched its first integration with Afterpay, providing Afterpay's BNPL functionality to sellers in the United States and Australia that use Square Online for e-commerce. More recently, in May 2022, Block announced the extension of Afterpay BNPL functionality to its millions of in-person sellers in the United States and Australia. See, Afterpay, FY21 Annual Report; FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., pp. 120 – 126; Square, Square Expands Afterpay Integration to In-Person Points of Sale, Square Press Release (May 17, 2022); Accenture, The Economic Impact of Buy Now, Pay Later in the US, cit.; Trina Paul, Afterpay review: Everything you need to know about this short-term 'buy now, pay later' option, CNBC (October 31, 2021). See footnote 3.

[87] Klarna is one of the fastest growing companies in Europe and the United States, providing payment and banking solutions for consumers and businesses. Klarna's offering includes BNPL payments and financing options, mobile banking services (bank accounts and savings accounts), and an open banking platform. The company published its full year financial results for 2021 in February 2022, reporting record levels of gross merchandise volumes (GMV) which grew by 42% to $80 billion driven by growth in various global markets, as well as a significant increase of net operating income by 38% to $1.6 billion. Over 147 million consumers now use Klarna's services, of which 46 million consumers were added through 2021 acquisitions, accelerating Klarna's global reach and expansion to 45 countries. The US market is Klarna's fastest-growing key market by volume and Klarna's second-largest by revenue, much of it driven by the strong adoption of Klarna's app offering and successful retail partnerships. US merchandise volumes more than tripled year on year (YoY), fueled by 71% growth in Klarna US consumers to 25 million in January 2022. Although Klarna's credit loss rates have reduced by over 30% since 2019, in absolute terms Klarna's credit losses are growing, mostly driven by Klarna's growth, expansion to new markets and inflow of new customers. The Klarna app is reported to be the second fastest-growing app on a downloads basis compared to major global payments peers. Among relevant geographic areas, the United States has the highest share of Klarna app users of any market and accounts for over 40% of global downloads, thus placing Klarna in the Top 10 US shopping apps. The company is well-funded having raised funds from a number of high-profile investors, including Softbank, Sequoia Capital, DST, Permira, Silver Lake, BlackRock, TCV and Singapore's GIC sovereign wealth fund. SoftBank led Klarna's most recent $640 million equity funding round in June 2021, valuing Klarna at $46 billion. The company is reported to plan to raise new money in a funding round that could see its valuation raise up to $60 billion. See, Klarna, Full Year Results 2021; FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., pp. 127 – 138; Alex Wilhelm, Klarna shows that BNPL growth is not cheap, Tech Crunch (March 7, 2022); Isabel Woodford, Klarna storms ahead of rivals across Europe and US, counting 16m+ new users in 2020, Sifted (May 4, 2021); Mary Ann Azevedo, Fintech giant Klarna raises $639M at a $45.6B valuation amid 'massive momentum' in the US, TechCrunch (June 10, 2021); Finextra, Klarna weighs new funding round, Finextra (February 10, 2022).

[88] Minneapolis-based BNPL company Sezzle provides an alternative payment platform offering customer the opportunity to split their orders at select online stores into four interest-free payments over six weeks. The company operates in the United States and Canada. Sezzle has listed in Australia and has been reincorporated as a public benefit corporation in 2020, making it the first BNPL corporation to gain such a status. In February 2022, Australian BNPL provider Zip announced its agreement to buy Sezzle. See, footnote 2.

[89] See, footnote 1.

[90] San Francisco-based Affirm has been growing exponentially. As the BNPL industry gains traction, its technology, network effect and brand moats have helped solidify its position as a market leader in the United States. Affirm offers installment loans to consumers at checkout or POS, with rates ranging from 0% to 10% or 30% annual percentage rate (APR) based on a consumer's credit. Consumers can use Affirm for purchases of $50 to $17,500 and can pay with debit cards, bank transfers or personal checks, with no late, service or prepayment fees. To assess creditworthiness, Affirm aggregates and analyzes data on individual consumers from various and different sources, in addition to FICO score. As it continues to attract more consumers and merchants into its ecosystem, Affirm has been growing and diversifying its offering beyond BNPL solutions, to include (among others) interest-bearing savings accounts, with no minimum deposit requirements and no fees, as well as a cash backs and rewards program. The company started trading on NASDAQ in January 2021. See, Affirm, 2021 Annual Report; FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., pp. 112 – 119; Riyado Sofian, Affirm: BNPL And Beyond, Seeking Alpha (February 15, 2022); Benjamin Pimentel, How Max Levchin stumbled into 'buy now, pay later, Protocol (October 4, 2021).

[91] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 24.

With the U.S. BNPL market being dominated by these players, newer entrants like Sunbit, Scratchpay, and Uplift among others have been more successful in targeting niche segments.[92]

The UK BNPL Market

BNPL has been thriving in the United Kingdom over the past couple of years. A report by Capital Economics (commissioned by Klarna) indicates that one-fifth of the UK adult population (c. 10.4 million people) used a BNPL service to make an online purchase (for aggregate c. £4.1 billion) in the United Kingdom in 2020.[93] Moreover, data published by Which? show that a third of UK consumers were using BNPL products as of May 2021.[94] The 2021 Global Payments Report by Worldpay estimates that BNPL transactions will grow 29% year-on-year to double market share in the United Kingdom by 2024.[95]

Six leading players make up the lion's share of the UK BNPL market – BNPL provider Klarna; three fintech companies from Australia and New Zealand (Afterpay (known as Clearpay in the United Kingdom),[96] Laybuy,[97] and Zip[98]), which have leveraged their home market expertise to launch services in the United Kingdom; and PayPal, which has capitalized on its existing user base to introduce "Pay in 3".[99] The UK BNPL market is rapidly growing, and more BNPL providers are now gaining momentum, including Zilch[100] and Butter.[101]

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[92] See, CB Insights, 50+ Companies Pushing Buy Now, Pay Later Across The World, CB Insights Research (June 30, 2021).
[93] See, Capital Economics, Buy Now, Pay Later (BNPL) and the new economic landscape, cit., pp. 5, 11.
[94] See, Which?, Under Pressure: Who Uses BNPL?, Which? Policy Report (May 2021), cit., p. 4.
[95] See, Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit.
[96] See, Accenture, Economic Impact of Clearpay in the UK, Accenture Report (commissioned by Clearpay) (2021).
[97] The New Zealand-headquartered BNPL provider Laybuy has most grown its activities in Australia and most recently in the United Kingdom. Laybuy allows online and in-store customers to split their purchase costs over six weekly interest-free installments. In May 2021, Laybuy secures $35 million funding to double down on UK expansion. See, e.g., Finextra, Laybuy raises A$35 million for UK market push, Finextra (May 19, 2021); UKTN, Klarna rival Laybuy secures $35M funding to double down UK expansion, UKTN (May 19, 2021).
[98] Zip offers interest free payment solutions called 'Zip Pay' and 'Zip Money', which allows online and in-store customers to spread the cost of items bought at selected retailers over 4 equal fortnightly payments. Zip has grown to cover various geographic areas including Australia, the United States, the United Kingdom, and New Zealand. The company is listed on listed on the Australian stock exchange. See, e.g., Zip, 2021 Annual Report; FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., pp. 164 and 165.
[99] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., pp. 14 – 16.
[100] BNPL firm Zilch offers its services in the United Kingdom and Europe and has recently launched in the United States with 150,000 pre-registered customers. Zilch has a distinctive 'customer first approach' in that it brings value directly to the consumers by allowing them to pay at any merchant that accepts Mastercard. It promotes flexible and responsible lending and uses soft background credit checks performed by Credit Kudos via Open Banking to determine affordability. Zilch leverages a business model that combines multiple revenue streams – including affiliate commissions – to cover the costs of its operations and borrowing and offer zero interest financing. Although Zilch's customer base cover various demographics, Millennials and Gen Z make up their primary user base. In the crowded BNPL arena, Zilch has been able to reach more than 1.7 million customers across the UK and is currently expanding across Europe and into the US market. In November 2020, Zilch boosted its valuation in a $110 million Series C funding round at a $2 billion valuation. See, e.g., FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., pp. 105 – 109; Zilch, Zilch Continues to Lead Responsible Lending in the Payments and BNPL Space, Zilch News (April 7, 2022); John Reynolds, Zilch doubles customers to 2 million in six months, Altfi (March 18, 2022); Zilch, Want to know more about Zilch's BNPL product If so, read on…, Zilch Blog (February 9, 2022); FFNews, Zilch and Mastercard announce expanded partnership to launch Zilch BNPL card across Europe, FFNews (January 13, 2022); Zilch, Buy Now, Pay Later Responsibly This New Year, Zilch Blog (January 1, 2022); Zilch, Pay Later with Zilch: How Zilch Makes it More Manageable, Zilch Blog (December 1, 2021); Aisling Finn, Zilch scoops $110m in debt and equity from Goldman Sachs and Daily Mail owner DMGT, Altfi (July 23, 2021); Zilch, Zilch announces partnership with Credit Kudos to shake up Buy Now Pay Later, Zilch Blog (October 16, 2020); Daniel Lanyon, Zilch launches US expansion with plans to win 125 million customers, Altfi (May 17, 2022).
[101] UK based BNPL provider Butter initially focused on the travel sector but has since expanded its offering by introducing the options for users to spread payments over two, three, four, six and ten-month periods, interest-free, via their BNPL shopping app with the in-app universal checkout. Butter raised £15.8m from BCI Finance, the credit arm of London based VC Blenheim Chalcot, and certain angel investors in the fintech space in March 2021. See, e.g., Dan Taylor, London-based Buy Now Pay Later fintech Butter raises £15.8 million, Tech.eu (March 30, 2021); Joanna England, Butter raises £15.8m in its latest funding round, FinTech (April 1, 2021).

Although most of these BNPL providers have started their journey with an embedded e-commerce checkout product that enables users to spread out payments, their operating models are different in relation to omnichannel capabilities, credit approval processes, and the application of late repayment fees.[102]

The EU BNPL Market

The EU BNPL market has been thriving for quite some time. BNPL solutions have found fertile ground in Europe, with BNPL options accounting for 8.1% of Europe's regional e-commerce spend in 2021 and nearly 2% of regional POS transaction value in 2021 according to data published by Worldpay.[103] BNPL is set to absorb a relevant share of the declining use of cash in Europe through 2025: BNPL earned a 1.9% share across Europe in 2021 and projects to 2.8% by 2025. [104]

BNPL continues its impressive growth in Nordic markets - in 2021, BNPL represented 11.7% of e-commerce share in Denmark, 12.8% in Finland, 18.1% in Norway, and 25.2% in Sweden. [105] Other European countries are rapidly catching up - BNPL accounted for 19.7% of e-commerce spend in Germany in 2021 and is expected to gain share through to 2025 steadily; BNPL projects growth from 4.1% in 2021 to 7.1% in 2025 in France; and BNPL products were also on the rise in Spain in 2021.[106]

BNPL pioneer Klarna has long dominated the EU BNPL market, but new global and local players have recently emerged and grown in popularity, including Scalapay,[107] Alma,[108] Twisto (acquired by Zip),[109] and Clearpay.

Leading and Emerging BNPL Market Players

Thus far, fintech BNPL providers have taken the lead and have captured most of the value being created in the BNPL market, to the point of diverting between $8 billion and $10 billion in annual revenues away from incumbent banks.[110]

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[102] See, Bain & Company, Buy Now, Pay Later in the UK, Consumers' Delight, Regulators' Challenge, cit., p. 16. See, also, Georgia-Rose Johnson, Buy now pay later (BNPL) statistics, Finder (March 1, 2021).
[103] See, Worldpay from FIS, The Global Payment Report for Financial Institutions and Merchants, cit., pp. 13, 64.
[104] Id., p. 14.
[105] Ibidem.
[106] Ibidem. See, also, Frida Polyak and Maxim Hofer, The Disruptive Potential of Buy Now Pay Later in Western Europe, Euromonitor International Insights (January 18, 2022).
[107] Italy-based BNPL provider Scalapay allows customers to defer a payment through interest-free monthly installments. Scalapay has rapidly grown its activities across Europe and is increasingly focusing on building innovative and flexible checkout solutions for merchants. Scalapay raised $497 million at a valuation of over $1 billion in a Series B round led by Tencent and Willoughby Capital in February 2022. See, e.g., PYMNTS, European BNPL Provider Scalapay Raises Nearly $500M, PYMNTS (February 23, 2022); Finextra, Scalapay joins BNPL unicorn club, Finextra (February 24, 2022).
[108] French BNPL provider Alma allows customers to pay in two, three or four installments. It also provides a payment option that lets customers buy selected items and pay fifteen or thirty days later. In addition, the company offers ten-month or twelve-month plans, which have become particularly popular with purchases such as consumer electronics devices or furniture. Alma. The company closed a closed a $130 million Series C round and raised $109 million in debt financing in February 2022. Alma is planning to invest the fresh capital to grow its services across Europe. See, e.g., Romain Dillet, BNPL payment startup Alma raises another $130 million round, TechCrunch (February 10, 2022); Finextra, French BNPL startup Alma raises €210 million, Finextra (February 14, 2022).
[109] The Prague-based Twisto was acquired for Euro 89 million by the Australian online payments platform Zip in May 2021. See, e.g., Business Wire, Zip Expands into Europe and the Middle East, with the Acquisitions of European BNPL Provider Twisto and UAE-based Spotii, Business Wire (May 23, 2021); Dan Taylor, Australian BNPL platform Zip acquires Prague-based Twisto for €89 million, Tech.eu (May 24, 2021); Finextra, Zip completes acquisition of Twisto, Finextra (November 15, 2021).
[110] See, McKinsey & Company, Buy now, pay later: Five business models to compete, cit.; M2P, Six Profitable BNPL Business Models to Unlock Infinite Value, Medium (August 27, 2021).

Leading BNPL players have increasingly focused on prominent retailer sign-ups, platform partnerships, and technology integrations to drive merchant adoption and lower customer acquisition costs.[111] For example, Affirm has struck deals with Walmart, Shopify, Peloton, and Amazon, among others;[112] Sezzle (acquired by Zip) has partnered with Target;[113] Klarna has teamed up with a wide range of high profile merchants, including Macy's and Harrods;[114] and Afterpay has signed up Gap.[115] Leading BNPL players have also offered seamless integrations into merchants' shopping carts by partnering with e-commerce platform plug-ins like Magento, Oracle Commerce, and Salesforce Commerce Cloud. Other BNPL players like Afterpay have teamed up with Google Pay and Apple Pay.[116]

As the BNPL market continues to grow and evolve, it also becomes increasingly competitive and more diversified.[117] For example, digital banks like Monzo and Revolut announced new credit features in 2021. Monzo launched Monzo Flex in September 2021 with the aim to give customers increased transparency, convenience, and control over their finances. Monzo Flex allows eligible users to spread the cost of online and in-store purchases in three installments interest-free, or over six and twelve installments at 19% APR (variable). Eligible users are assigned a credit limit and can edit their installment plans at any time (with no fees). Their Monzo Flex balance sits alongside their Monzo account, with the convenience that all their spending is in one integrated place.[118] Revolut announced its plan to enter the BNPL market in September 2021. The company is reportedly working on a checkout feature, which will allow customers to spread the cost of any purchase made using Revolut cards. The feature is in early development and is currently being tested.[119]

Large technology and fintech companies have also started adding BNPL payment options directly or through partnerships. In doing so, they seek to leverage their vast customer bases, powerful brands, and ability to drive consumers to merchants. For example, Stripe has recently teamed up with a few BNPL players, including Klarna, Affirm, Quadpay (acquired by Zip), and Four.[120] Similarly, Adyen has joined forces with Afterpay to deliver flexible payments across key markets.[121] Meanwhile, Square has

[111] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit. pp. 24 and 25.
[112] See, e.g., Sarah Perez, Affirm's latest partnership brings its alternative financing to Walmart's US stores and website, TechCrunch (February 27, 2019); Finextra, Affirm introduces Shop Pay Installments for Shopify merchants, Finextra (June 11, 2021); Tara Siegel Bernard, Amazon strikes a deal with Affirm, the buy-now pay-later provider, The New York Times (August 30, 2021)
[113] See, Finextra, Target taps Affirm and Sezzle for BNPL, Finextra (October 6, 2021).
[114] See, Richard Milne, Macy's takes stake in Klarna as part of payment partnership, Financial Times (October 6, 2020); Supantha Mukherjee, Macy's invests in online 'buy now, pay later' firm Klarna, Reuters (October 6, 2020); Daniel Lanyon, Klarna partners with Harrods, Altfi (December 7, 2021).
[115] See, e.g., PR Newswire, Gap Inc. and Afterpay Announce New Partnership In Time for Holiday Shopping, PR Newswire (November 11, 2020); PYMNTS, Retailer Gap Partners With BNPL Platform Afterpay To Boost Holiday Shopping, PYMNTS (November 11, 2020).
[116] See, e.g., Finextra, Afterpay introduces instore instalment payments on Apple Pay and Google Pay spending, Finextra (July 15, 2020).
[117] See., Eric Johansson, 40 Buy-Now-Pay-Later companies you need to know about, Verdict (October 16, 2021, updated February 4, 2022); CB Insights, 50+ Companies Pushing Buy Now, Pay Later Across The World, cit.
[118] See, Monzo, Introducing Monzo Flex – a better way to pay later, wherever you use Monzo, Monzo Blog (September 16, 2021).
[119] See, e.g., Finextra, Revolut plans to compete on 'buy now, pay later' market – Evening Standard, Finextra (September 7, 2021); Aisling Finn, Revolut set to take on Klarna with its own BNPL offering, Altfi (September 7, 2021).
[120] See, e.g., Daniel Lanyon, Klarna and Stripe enter 'strategic partnership', Altfi (October 26, 2021); PYMNTS, QuadPay, Stripe Debut New Buy Now, Pay Later Option, PYMNTS (May 7, 2020); Sam Brake Guia, Four Partners With Stripe to Empower Global Shoppers to Easily Budget Their Purchases, StartupBeat (August 28, 2020).
[121] See, Adyen, Adyen expands global partnership with Afterpay, Adyen Press Release (May 9, 2022).

launched a program with its peer-to-peer Cash App offering short-term, 5% fixed-rate loans between $20 and $200 after introducing its Square Installments product in 2018.[122]

In parallel, PayPal has added BNPL solutions called 'Pay in 3' (UK), 'Paiement en 4x solution' (France), and 'Pay in 4' (US) to its growing array of payment options, which are a comparable offering to the standard 0% APR installment offering from leading BNPL providers like Klarna and Afterpay. With 'Pay in 4' U.S. users can pay for purchases between $30 and $600 in four interest-free installments over six weeks, while with 'Pay in 3' UK users can split purchases of between £30 and £2,000 in three interest-free payments (with the first due at the time of purchase and subsequent payments due every month on the same date). Users can manage their payments in their PayPal wallet, app, and online and set up automatic repayments. Interestingly, PayPal has sought to capitalize on its extensive base of merchants and its massive profitable network and has decided to offer this BNPL functionality as part of its service without charging merchants any additional fees.[123]

In July 2021, Apple announced a partnership with Goldman Sachs to launch a BNPL service through Apple Pay called Apple Pay Later, giving Apple Pay users an option to spread payments for their purchases across four interest-free payments every two weeks, or across several months with interest. When making purchases at retail or online stores through an Apple Pay Later plan, users will be able to select any credit card to make their payments over time.[124] More recently, in March 2022, Apple acquired Credit Kudos, a UK fintech company that uses open banking technology to enhance affordability and risk assessments, thus helping lenders streamline underwriting and improve decision-making accuracy. This acquisition is expected to accelerate Apple's move into payment technology and products such as BNPL.[125]

As BNPL players expand into new geographies and compete for global market share, they also face increased competition from incumbents, including established banks, card issuers, payment networks, and other financial institutions, which are all ramping up their efforts in the payment space. Incumbents are increasingly seeing the growth of BNPL as a signal to rethink the lending landscape and their role in it. Some of them are exploring various integrations across the purchase journey to scale, rise visibility and engage more younger generations. They are also rethinking and updating their risk models to address evolving customer behaviors and needs.[126]

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[122] See, e.g., Anthony Ha, Square's Cash App tests new feature allowing users to borrow up to $200, TechCrunch (August 12, 2020); PYMNTS, Square's Cash App Tests Small-Dollar, Short-Term Loans, PYMNTS (August 12, 2020).

[123] See., CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 30 (noting "[t]his pricing strategy is crucial to helping PayPal grow merchant adoption and subsequently drive volume and higher share of checkout over competitors. Additionally, because PayPal typically charges merchants 2.9% + $0.30 per transaction, the fixed fee component actually helps drive higher take rates (the percentage of sales Paypal gets to keep as revenue), while simultaneously driving more incremental revenue for merchants.").

[124] See, e.g., Mark Gurman and Sridhar Natarajan, Apple, Goldman Plan 'Buy Now, Pay Later' Service to Rival Affirm, Bloomberg (July 13, 2021); Daniel Lanyon, Apple and Goldman Sachs join forces to take on Klarna with Buy Now Pay Later, Altfi (July 14, 2021); Ron Shevlin, Apple And Goldman Sachs To Launch Apple Pay Later, A Buy Now Pay Later Service, Forbes (July 13, 2021).

[125] See, e.g., Liza Tetley, Why did Apple buy Credit Kudos? Here are 3 possibilities…, Altfi (March 24, 2022); Finextra, Apple quietly acquires Credit Kudos for $150 million, Finextra (March 23, 2022); Giles Turner, Apple Acquires U.K. Financial Health Startup Credit Kudos, Bloomberg (March 23, 2022); James Hurley, Apple's fintech deal opens door to buy now, pay later, The Times (March 24, 2022).

[126] See, e.g., Julian Alcazar and Terri Bradford, The Rise of Buy Now, Pay Later: Bank and Payment Network Perspectives and Regulatory Considerations, Federal Reserve Bank of Kansas City Payments System Research Briefing (December 1, 2021); IBS Intelligence, Why BNPL should be now, not later, for banks, IBS Intelligence Blog (January 26, 2022).

Certain incumbents have backed and/or partnered with white-label BNPL platforms providers to offer their BNPL products and thus diversify their loan portfolios. These providers can help banks and other financial institutions get into the BNPL market at speed with modern, cloud-based platforms that integrate well and deliver an excellent experience to their customers and merchant partners, while carefully managing relevant risks and compliance requirements. For example, Barclays has joined forces with fintech firm Amount to offer merchants a white-label POS BNPL financing service,[127] while HSBC and ING have recently led a $30 million Series B fundraise in BNPL white-label provider Divido's.[128]

There are a variety of white-label BNPL enablement solutions, ranging from full-stack offerings that provide complete BNPL solutions to more sectional offerings that link merchants and lenders and/or provide credit decisioning processes. Some providers also offer data analytics, reporting tools, platform, automated fraud prevention and verifications, and other value-added services. All these white-label BNPL enablement solutions aim to unlock POS power for banks and other financial institutions and enable them to compete with leading fintech POS lenders, while also providing customers and retailers with the reliance, trust, and stability that go along with working with established financial institutions.

Selected White-Label Providers' Value Add

AMOUNT Limepay Bread vyze divido SKOPS Pledg Jifiti. neopag. ChargeAfter

	White Label Providers	BNPL providers	Payment Gateways
Payment Plans	Yes	Yes	No
Branding	Merchants / Lenders	Theirs	N/A
Merchant dashboard	Full	Limited	Limited
Reporting	Full	Limited	Limited
Purchase behavior insights	Yes	No	Yes
Customers stay on merchant site	Yes	No	No
Accepted payment types	All major cards and digital wallets	Major cards and bank accounts	Varies – usually mostly cards and digital wallets

Source: FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., p. 16.

Some banks have 'rent' their balance sheet to BNPL providers as an alternative approach. Under this model, BNPL companies typically purchase the loans from the originating bank shortly after origination in exchange for a fee which is often a relatively small percentage of the total origination. An interesting example is a collaboration between Cross River Bank and Affirm, where Cross River Bank provides Affirm with banking services and funding capacity.[129]

Other major banks and card issuers have introduced, or are planning to introduce, their own BNPL offering and/or have decided to incorporate BNPL solutions into existing credit cards. Among them,

[127] See, e.g., FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit., pp. 34 – 36; PR Newswire, Barclays US Consumer Bank Expands Point-of-Sale Financing Suite to Include Installment Options Powered by Amount, PR Newswire (April 27, 2021); Yuri Kropelnytsky, BNPL's Growing Role in Unsecured Lending, Finextra (January 19, 2022); Ha Dao, How Banks Can Ride the BNPL Trend, Finextra (August 24, 2021).
[128] See, e.g., Finextra, HSBC and ING invest in BNPL firm Divido, Finextra (June 2, 2021); PYMNTS, BNPL Retail Finance Platform Divido Raises $30 Million, PYMNTS (June 2, 2021).
[129] See, Julian Alcazar and Terri Bradford, The Rise of Buy Now, Pay Later: Bank and Payment Network Perspectives and Regulatory Considerations, cit.

Citigroup has launched 'Citi Flex Pay',[130] JPMorgan Chase offers 'My Chase Plan',[131] Goldman Sachs has introduced a BNPL solution via its Marcus app,[132] American Express offers 'Pay It Plan It' and 'Pay Over Time',[133] Santander has been scaling its BNPL product Zinia in Europe,[134] and NatWest has recently announced its intent to launch a BNPL program during the summer of 2022.[135] Customers using these services can finance transactions in installment-style payments. Unlike the BNPL models discussed above, financing typically happens after a transaction, and users must separately go to their accounts and select which qualifying transactions to finance. This is intended to offer customers a different way to engage with credit products, while also avoiding eating into credit card revenues.[136]

As they anticipate material changes in how consumers choose to pay for goods and services and potential loss of revenues, some major credit card and payment networks are looking for other ways to become part of the payment process. For example, Visa and Mastercard have recently partnered with, invested, and acquired companies to grow their BNPL offering. In doing so, they have sought to capitalize on their existing extensive relationships with merchants and retailers to get a piece of a growing market.[137]

Visa has teamed up with alternative credit and BNPL platform Four to provide customers worldwide with the ability to split payment options online and in stores.[138] In addition, it has invested and partnered with POS financing platform ChargeAfter[139] and is growing its installment program, Visa Installments, by collaborating with a wide range of merchant partners.[140]

Similarly, in an effort to build and scale its BNPL capabilities, Mastercard has acquired Vyze (a POS lending marketplace that connects merchants with multiple lenders[141]) and has built a vast network of

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[130] Citigroup's 'Citi Flex Pay' allows cardholders to split eligible purchases into monthly payment plans and a fixed interest rate over a period of one to three years.

[131] JP Morgan Chase's 'My Chase Plan' is available for purchases over $100 and enables cardholders to break up card purchases into monthly payments with no interest, and with a fixed monthly fee. The repayment timeframe can range from three to eighteen months, based on the purchase amount, the cardholders's creditworthiness and account history.

[132] Marcus by Goldman Sachs has launched 'MarcusPay', a POS financing product with JetBlue Airways. Cardholders can use 'MarcusPay' for an eligible purchase that costs between $300 and $10,000 and can pay over six, twelve and eighteen months at APRs ranging from 8.99% to 29.99%.

[133] Amex's 'Pay It Plan It' allows cardholders to split up large purchases into monthly installments with a fixed fee and no interest. With Amex's 'Pay Over Time', customers have the option to pay eligible charges over time with interest.

[134] See, e.g., Finextra, Santander bets big on BNPL with new service Zinia, Finextra (January 26, 2022); Oliver Smith, Battle of the BNPLs: Santander aims to be "leader" in the European pay later market with Zinia, AltFi (January 26, 2022); PYMNTS, Santander's BNPL Product Zinia Expands to the Netherlands, PYMNTS (January 26, 2022).

[135] See, e.g., Charlie Conchie, NatWest to roll out buy-now pay-later credit as demand booms, City A.M. (March 22, 2022); Finextra, NatWest hops aboard BNPL bandwagon, Finextra (March 22, 2022); Lauren Smith, NatWest to Launch a Buy Now, Pay Later Credit Service This Summer, MoneyExpert (March 22, 2022).

[136] See, CB Insights, Disrupting The $8T Payment Card Business: The Outlook On 'Buy Now, Pay Later', cit., p. 26.

[137] Id., pp. 28 and 29. Most of the major BNPL payment models are built on top of Visa's and Mastercard's existing payment networks. This means that for every transaction that BNPL players facilitate, they forfeit part of the fees to the incumbents for processing and clearing the payment. Although major card networks can benefit from this linkage, the longer-term success of BNPL payment models creates significant competition around merchant fees and fees from payment volumes, including because many BNPL transactions are completed with debit cards. This is relevant for major card networks as debit transactions typically involve lower interchange fees compared to credit. See, also, Mckinsey Buy now, pay later: Five business models to compete, cit. (noting "[r]oughly 80 to 90 percent of these transactions happen on debit cards, with average ticket sizes of between $100 and $110."); Alex Rampell, Why is "Buy Now, Pay Later" (BNPL) an early threat to trillions of dollars of market cap, Twitter Post (September 8, 2021) (a16z partner Alex Rampell pointed out in a Twitter thread that BNPL is building a parallel payments system that could drain volume away from Visa and Mastercard).

[138] See, e.g., NewsWire, Four Partners With Visa to Expand Access to Buy Now, Pay Later Options for Shoppers Worldwide, NewsWire (October 22, 2020).

[139] See, e.g., Finextra, Visa invests in POS financing platform ChargeAfter, Finextra (February 12, 2020); Michael Moeser, Visa invests in point-of-sale lender ChargeAfter, AmericanBanker (February 12, 2020).

[140] See, e.g., Visa, Visa Helping Fuel 'Buy Now, Pay Later' Growth Around the World, Visa News (October 27, 2021); PYMNTS, Visa Launches Visa Installments Pilots in the US, YMNTS (July 14, 2020).

[141] See, e.g., PYMNTS, Mastercard buys POS Financing Provider Vyze, PYMNTS (April 15, 2019); Finextra, Mastercard moves into POS financing with Vyze acquisition, Finextra (April 16, 2019).

partners, including Spotii, FlexiGroup's Bundll, Splitit, TSYS, Amount, Lithic, i2c, and Deserve.[142] In addition, the Mastercard BNPL program "Mastercard Installments" makes BNPL available to millions of consumers and merchants in the United States, the United Kingdom, and Australia. The program enables banks, lenders, fintech companies and wallets to offer a variety of BNPL experiences to consumers - including a zero-interest, pay-in-four model – with seamless integration and flexibility across the entire acceptance network.[143]

[142] See, e.g., BusinessWire, Mastercard Drives Scale of Buy Now, Pay Later with Raft of New Partners, BusinessWire (March 16, 2022); Kate Fitzgerald, How Mastercard is linking banks to BNPL, American Banker (March 21, 2022); Finextra, Mastercard adds BNPL partners, Finextra (March 18, 2022).

[143] See, Zacks Equity Research, Mastercard (MA) Enters BNPL Market With Mastercard Installment, Nasdaq (September 28, 2021).

CHAPTER 2

HEIGHTENED REGULATORY OVERSIGHT FOR BNPL IN THE UNITED STATES

Over the last few years, BNPL use has become widespread in the United States, and the U.S. BNPL market has grown massively, both in terms of offerings and popularity. BNPL's rise has drawn increased scrutiny from U.S. federal and state regulators, particularly concerned with potential risks to consumers. Federal regulators have examined BNPL products and services more closely and have assessed to what extent existing consumer protection laws cover them, including the Truth in Lending Act ("TILA")[144] and the Gramm-Leach-Bliley Act ("GLBA").[145] In parallel, state regulators have raised consumer protection concerns regarding BNPL products and services and have taken several actions against BNPL companies resulting into formal investigations and settlements. Federal and state regulators appear to have placed their review of BNPL products on an expedited timeline, and relevant regulatory changes may be on the horizon. The following sections discuss these developments and the evolving regulatory framework for BNPL in the United States in detail.

2.1 The CFPB's Consumer Alert on BNPL (July 2021)

The Consumer Financial Protection Bureau ("CFPB") monitors the consumer credit market for new forms of financing to ensure that consumers are adequately informed about financial offerings and protected from risky and dangerous practices.

On July 6, 2021, the CFPB issued a consumer alert warning consumers of the risks of BNPL.[146] The alert was likely triggered by a spike in the use of BNPL during the Covid-19 pandemic, which prompted over 42% of U.S. consumers to use BNPL at least once.[147]

In explaining how BNPL works, the CFPB notes that BNPL is a type of deferred payment option that typically allows consumers to purchase items with little to no money paid up-front, followed by installment payments. Products eligible for BNPL range in price from less than $100 to several thousand dollars. Consumers can generally select BNPL options at checkout online or in an app. If approved, the consumer receives the goods, and the purchase cost is then split into a payment schedule, typically four fixed payments made bi-weekly or monthly until the balance is paid in full, with no interest or finance charges. The CFPB observes that the approval process tends to be quite fast and, different from credit card companies or other consumer loan lenders, BNPL companies don't usually conduct a "hard" credit check when a consumer applies.[148]

In addition to cautioning consumers not to overextend their finances, the CFPB encourages consumers to carefully research whether a BNPL company reports to credit bureaus before using its service. The

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[144] The TILA seeks to ensure that consumers are provided with meaningful, completed and adequate disclosure of credit terms, among other things. The TILA disclosure requirements typically apply to consumer credit that is subject to a finance charge or payable in more than four installments. The TILA is implemented by the Consumer Financial Protection Bureau through Regulation Z.

[145] The GLBA is a federal privacy law that sets out a framework for regulating the privacy practices of financial institutions in relation to non-public personal information of individuals who obtain financial services for personal, family or household use from "financial institutions". GLBA defines "financial institution" broadly as an institution that engages in financial activities.

[146] See, Consumer Financial Protection Bureau (CFPB), Should you buy now and pay later?, CFPB Consumer Alert (July 6, 2021).

[147] See, Credit Karma, 72% of Americans saw their credit scores drop after missing a 'buy now, pay later' payment, survey finds, cit.

[148] See, Consumer Financial Protection Bureau (CFPB), Should you buy now and pay later?, cit.

CFPB notes that most BNPL credit is not reported to consumer reporting agencies. This means that consumers using BNPL products won't generally be able to rely on their BNPL repayment behavior to establish credit or build a credit score. On the other hand, late payments owed to a BNPL company are often reported to consumer reporting agencies, thus negatively impacting a consumer's credit history. [149]

The CFPB warns consumers that, while many BNPL companies don't charge interest, most BNPL companies charge late fees if a consumer misses a payment. Moreover, consumers may be blocked from future purchases until past due payments are made, and their debt could be sent to a debt collector for collection if they fail to repay. For these reasons, the CFPB recommends consumers to carefully review applicable terms and conditions to understand their obligations before using BNPL products. It also warns consumers that their banks may charge an overdraft or a non-sufficient funds fee if the consumers enroll in automatic repayments of BNPL credit through their debit card or bank account and don't have enough funds to cover the required payments. [150]

The CFPB notes that BNPL credit currently lacks the consumer protections that apply to credit cards, such as dispute protections for faulty purchases or scams. Moreover, BNPL arrangements raise complications within typical customer service touchpoints that may create consumer harm. For instance, returning merchandise bought with BNPL can sometimes be complicated and expensive. Therefore, consumers should carefully examine and understand the merchant's specific return policies.[151]

Lastly, the CFPB advises consumers to carefully review BNPL terms and conditions and compare BNPL to other payment options, which, similarly to BNPL, let consumers repay purchases over a longer time but may have very different terms. [152]

2.2 The CFPB's Consumer Credit Card Market Report (September 2021)

In September 2021, the CFPB released its 5th biennial Consumer Credit Card Market Report ("2021 CCCM Report").[153]

The CFPB issued the 2021 CCCM Report under the Credit Card Accountability Responsibility and Disclosure Act ("CARD Act")'s requirement that the CFPB reports every two years on the state of the consumer credit card market. The 2021 CCCM Report updates the results from the CFPB's 2019 Consumer Credit Card Market Report and details the CFPB's recent review of the consumer credit card market and the impact of the CARD Act during the period 2019 - 2020. The 2021 CCCM Report also considers responses to the request for information issued by the CFPB in August 2020, along with other data from regulators, industry, and consumers.

In the 2021 CCCM Report, the CFPB notes that the U.S. credit card market (the largest U.S. consumer lending market measured by a number of users) has continued to grow in almost all measures until suddenly reversing course in March 2020. The Covid-19 pandemic significantly impacted how many consumers use and interact with credit cards. The CFPB estimates that 181 million of the 258 million

[149] Ibidem.
[150] Ibidem.
[151] Ibidem.
[152] Ibidem.
[153] See, Consumer Financial Protection Bureau (CFPB), The Consumer Credit Card Market, CFPB Report (September 2021).

adults in the United States (c. 70%) had a credit card account in their name as of the end of 2020.[154] Fewer consumers applied for new credit cards in 2020, while existing cardholders paid off the highest share of their credit card debt in recent years.[155] Credit card debt peaked at $926 billion in 2019, but by the second quarter of 2020 consumers had reduced card balances to $811 billion, the largest six-month reduction in U.S. history. Credit card debt continued to fall to $825 billion by the end of 2020.[156] Additionally, late payment and default rates fell to historic lows, most notably for consumers with below-prime scores. [157] General-purpose credit card payment rates have continued to grow, with about one-third of balances paid off by cycle end. [158]

The 2021 CCCM Report acknowledges that several events and consumer behavioral trends may have contributed to the decline in general-purpose card debt in 2020. The beginning of the Covid-19 pandemic saw reductions in spending, which may have enabled some cardholders to use available funds to pay down debt. In parallel, unprecedented levels of direct government assistance may have provided some consumers with additional disposable income utilizable to reduce balances. Reductions in payments on other credit products may have also been a relevant factor. Yet, evidence suggests that some consumers may have simply shifted purchasing behavior away from credit cards to debit cards or other forms of credit, such as BNPL or personal loan products. [159]

Utilization rates declined across credit score tiers, and the share of consumers with below-prime scores who used 90% or more of their general-purpose credit line fell to record lows in 2020. [160]

Approval rates on applications for general-purpose credit cards have continued to decline since 2015. The Covid-19 pandemic accelerated this trend, with the overall approval rate decreasing from 41% in 2019 to 36% in 2020. Consumers with prime and near-prime credit scores saw the most significant reduction in approval rates of 11% and 10%, respectively, as institutions tightened underwriting in response to the Covid-19 pandemic. [161]

Digital engagement grew consistently across all age groups and nearly every platform type in 2020. The 2021 CCCM Report finds that 88% of all general-purpose credit applications were made via digital channels (i.e., smartphones, desktops, and tablets) in 2020. A digital channel that has become increasingly prominent is mobile devices, with mobile accounting for 52% of new applications in 2020, up from 43% in 2018.[162]

The 2021 CCCM Report further notes that access to digital technology for consumers and providers has continued to affect the design and offering of consumer credit products and has rapidly changed how consumers obtain and use credit cards.[163] Recent innovations have created new opportunities for 'thin-file' or 'credit invisible' borrowers to acquire credit cards and build or repair their credit history. These

[154] Id., pp. 25 and 26.
[155] Id., pp. 26 and 27.
[156] Id., pp. 27 and 28.
[157] Id., pp. 28 and 29.
[158] Id., pp. 35 and 36.
[159] Id., pp. 29 and 30.
[160] Id., pp. 79 and 80.
[161] Id., pp. 69 and 70.
[162] Id., pp. 66 and 67.
[163] Id., pp. 158 and 159.

new offerings leverage several innovative approaches, including using new types of data to facilitate underwriting and new product structures and features.[164]

Innovations aimed at improving credit access have continued to grow in the number of offerings and users. In the 2021 CCCM Report, the CFPB notes that BNPL products and services offer a new form of purchasing with payments split into a number of installments to be repaid over time, through debit and credit cards, typically by automatic repayment.[165] BNPL providers are among the growing number of non-banks that utilize consumer-authorized access to account data to deliver their service, including verifying consumer information and facilitating payments.

Since 2019, the popularity of BNPL has continued to grow, both abroad and in the United States. The 2021 CCCM Report highlights a significant jump in U.S. BNPL lending, from $3 billion in 2019 to $39 billion in 2020, suggesting this may exceed $100 billion annually within the next three years.[166]

The CFPB observes that the increased pace of adoption of BNPL has been partially driven by the Covid-19 pandemic, which prompted many consumers to shift spending online, thus creating an opportunity for retailers partnering with financial companies to offer BNPL at digital POS, being the primary channel by which the product is provided.[167] The CFPB further acknowledges that the extent to which BNPL competes directly with credit cards is still unclear. While BNPL products and services shift some volume from other payment methods like credit cards, a portion of BNPL volume may come from sales originating from the availability of BNPL itself.[168]

The CFPB then warns that certain key differences between BNPL loans and credit cards may create risks to consumers.[169] For example, unlike credit card providers, BNPL lenders are not required to consider the consumers' ability to repay before extending credit. BNPL providers do not typically report BNPL credit to credit bureaus, and users can, therefore, potentially be granted unsustainable BNPL loans across different providers and may face difficulties repaying one or many of them.[170] Moreover, some BNPL loans may not come with the same disclosures as other types of consumer credit. Some BNPL providers of zero-interest loans of four payments or less have argued that they do not meet the TILA definition of "creditor" and therefore are not required to provide TILA disclosures.[171] Additionally, BNPL late fees are not associated with specific regulations, and BNPL users do not have the same billing error resolution procedures available to credit card users.

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[164] Id., p. 159.
[165] Id., pp. 163 and 164.
[166] Ibidem. See, also, Brian Riley, Buy Now, Pay Later: Gaining Scale and the Disrupting Status Quo in Lending, Mercator Advisory Group Report (May 7, 2021).
[167] See, Consumer Financial Protection Bureau (CFPB), cit., pp. 163-164. See, also Peter Rudegeair et al., Covid-19 Economy Boosts 'Buy Now, Pay Later' Installment Services, The Wall Street Journal (December 30, 2020); and Stuart Condie, 'Buy Now Pay Later' Is Having a Moment as Pandemic Changes Shopping Habits, The Wall Street Journal (July 11, 2020).
[168] See, Consumer Financial Protection Bureau (CFPB), cit., p. 165 (and accompanying notes). See, also, Maurie Backman, Study: Buy Now, Pay Later Services Continue Explosive Growth, Motley Fool Insights (Updated March 22, 2021) (discussing the results of a recent consumer survey showing that consumers view BNPL as a potential alternative to credit cards, with 62% of respondents arguing that BNPL could replace their credit cards, but only 27% being supportive of that scenario).
[169] See, Consumer Financial Protection Bureau (CFPB), cit., pp. 165 and 166.
[170] Id., p. 165 (and accompanying notes).
[171] Id. pp. 165 and 166 (and accompanying notes).

The 2021 CCCM Report notes that following BNPL's explosive growth, traditional credit card issuers and networks like Visa and Mastercard are investing in more ways to offer similar plans with "fixed-payment" features.[172]

Against the described background, the CFPB expresses its intent to continue to monitor the developing market for new forms of POS financing, whether offered independently from or in conjunction with credit card products, to ensure consumers are adequately informed and protected from risky practices and at the same time can benefit from consumer-friendly innovation and competition.[173]

2.3 The CRS's Insights on BNPL (October - November 2021)

In October 2021, the Congressional Research Services ("CRS") published a report discussing the BNPL financing market and potentially related policy issues ("CRS Report").[174]

The CRS Report notes that non-bank financial companies provide a variety of BNPL financing solutions. Although these companies are not regulated as banks for safety and soundness, they must comply with federal consumer protection and data security laws. At the federal level, the CFPB has the authority in non-bank consumer financial markets to write regulations, enforce rules, and supervise companies in some instances.[175]

While BNPL financing can provide access to credit and flexibility to consumers, the CRS Report points out that it may also introduce consumer protection risks. This trade-off may be particularly acute for younger or subprime consumers.

The CRS Report identifies four main policy issues relating to BNPL financing:

- Unsustainable Debt Risks - Although BNPL providers do not typically charge initial interest or fees, consumers may be subject to accruing charges and penalties for late or missed payments. Consumers who have unpaid BNPL payments could also be blocked from future purchases or have their debts sent to debt collectors.[176]
- Consumer Disclosure Risks - Depending on the relevant arrangements, BNPL financing may not be subject to similar disclosure requirements as other consumer credit products, including in relation to disclosure requirements under the TILA. This creates a risk that consumers may not understand the terms of BNPL financing (including late payment fees) before using them. In addition, BNPL financing doesn't have certain consumer protections that are common in more traditional financial products, including dispute protections.[177]
- Consumer Credit Reporting - Many BNPL providers do not regularly report information to consumer credit bureaus. Consumers may therefore miss out on the opportunity to build a credit history, particularly those who pay their BNPL financing on time and have limited credit histories. Moreover, because BNPL debts in collection can be reported to consumer credit

[172] Id., pp. 166 and 168.
[173] Id., p. 167.
[174] See, Congressional Research Services (CRS), Rapidly Growing "Buy Now, Pay Later" (BNPL) Financing: Market Developments and Policy Issues, CRS Report (Updated November 1, 2021).
[175] Id., p. 2.
[176] Ibidem.
[177] Ibidem.

bureaus, consumers may still negatively impact their credit scores if they become delinquent on BNPL payments.[178]

- Consumer Data Privacy, Control, and Security - BNPL operations may introduce privacy and cybersecurity concerns. BNPL providers often access sensitive consumer data, which is valuable to companies that want to understand consumer behavior and market new products and services. Consumers may not fully appreciate how their data and information are being collected and processed by BNPL providers and may have limited ability to control or correct it. This, in turn, can make it difficult for consumers to protect their privacy, obtain redress for data breaches, or avoid other negative consequences from the misuse of their data.[179]

2.4 The U.S. House of Representatives Committee on Financial Services' Hearing on BNPL Programs (November 2021)

On November 2, 2021, the Task Force on Financial Technology of the U.S. House of Representatives Financial Services Committee ("FSC") held a hybrid hearing entitled "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products", urging U.S. regulators to examine the BNPL industry.[180] The hearing had one panel with five witnesses: Dr. Kristen E. Broady (Fellow, Metropolitan Policy Program, The Brookings Institution), Penny Lee (CEO, Financial Technology Association), Lauren Saunders (Associate Director, National Consumer Law Center), Marisabel Torres (Director, California Policy, Center for Responsible Lending) and Brian Tate (CEO and President, Innovative Payments Association).[181]

In the accompanying memorandum, the FSC highlights the rise in consumer loan products offered by fintech companies such as BNPL, earned wage access, and overdraft avoidance products, and notes that these products have attracted attention for their rapid growth and popularity, as well as the potential consumer protection concerns that they create.[182] Although these products have been designed to help individuals manage their personal cash flow, the FSC warns that they have also the potential to create unsustainable levels of debt. The FSC notes that many lending disclosure requirements (including those

[178] Ibidem.
[179] Id., p. 3.
[180] See, U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" (November 2, 2021).
[181] See, Kristen E. Broady (Fellow, Metropolitan Policy Program, The Brookings Institution), Written Testimony submitted to U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" (November 2, 2021); Penny Lee (CEO, Financial Technology Association), Testimony before the U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" (November 2, 2021); Lauren Saunders (Associate Director, National Consumer Law Center), Testimony before the U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" (November 2, 2021); Marisabel Torres (Director, California Policy, Center for Responsible Lending), Testimony before the U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" (November 2, 2021); and Brian Tate (CEO and President, Innovative Payments Association), Testimony before the U.S. House of Representatives Committee om Financial Services, Task Force on Financial Technology, Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products" (November 2, 2021).
[182] See, U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products", Committee Memorandum (November 2, 2021).

under the TILA) may not apply to these products, thus creating concerns regarding consumers' understanding of the associated risks.[183]

The FSC observes that BNPL products allow consumers to purchase and take possession of items immediately and pay for them over a certain period or with a specified number of payments, usually without accruing interest.[184] BNPL products may target "thin credit" file individuals who may not qualify for traditional credit cards, and younger consumers may be more likely to use BNPL. The FSC notes that the BNPL market has proliferated in recent years, with current data suggesting a 230% increase in BNPL use since early 2020.[185]

The FSC observes that some of the leading BNPL companies (including Klarna, Afterpay, Affirm, Splitit, and Sezzle) have reached high market values, despite often being loss-generating operations.[186] Their valuations may reflect expected revenues from sources indirectly related to the companies' BNPL business, such as access to customer data and spending patterns and the ability to cross-sell traditional banking services.[187]

Consumers may use BNPL payment products directly through a merchant that embeds the BNPL solution at check-out or the BNPL company's platform in a browser extension to purchase from retailers. Applications for financing take place at check-out, and BNPL companies determine financing terms based on a "soft" credit check and a consumer's tenure and performance on the platform.[188]

The FSC notes that BNPL companies may charge a late fee if customers do not make a payment after a grace period, and nonpayment may curtail future opportunities. Payments made on many of these products are typically not reported to credit bureaus, although, as the FSC notes, some BNPL companies report delinquencies to credit reporting agencies.[189]

The FSC then explains that BNPL companies generate most of their revenue by charging merchants for the services provided, which the merchants are generally willing to pay because of the opportunity to increase customer acquisition.[190] Lastly, while some companies that offer BNPL products operate independently, the FSC notes that others partner with banks to originate most of their loans and then repurchase the loans and hold them on their balance sheet or sell them to third parties.[191]

Significantly, although emerging fintech credit products (including BNPL products and services) can provide access to credit or cash-flow flexibility to consumers who might not obtain traditional bank credit at better terms, the FSC stresses that emerging fintech credit products may also pose relevant risks to consumers. These include risks relating to unsustainable debt, lack of adequate consumer disclosure or notice, consumer credit reporting, and consumer data privacy, control, and security.[192]

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[183] Ibidem.
[184] Id., p. 2.
[185] Ibidem (and accompanying note 8).
[186] Ibidem (and accompanying note 10).
[187] Ibidem (and accompanying note 13).
[188] Ibidem (and accompanying note 16).
[189] Ibidem (and accompanying note 17).
[190] Ibidem (and accompanying note 18).
[191] Id., p. 3 (and accompanying note 19).
[192] Id., p. 5.

The FSC notes that lenders offering new credit products (including BNPL products and services) are not typically required to assess the consumer's ability to repay before issuing the financing. As a result, some consumers may accept an unsustainable debt without fully understanding the terms and consequences of late or nonpayment.[193] Moreover, some emerging fintech cash flow products have uncertain disclosure regimes, and it may not be immediately clear whether TILA disclosure requirements apply or not. Some of these products might not have consumer protections like traditional financial products, including dispute protections.[194] Acknowledging that many of these fintech consumer products do not report consumers' payment information to the credit bureaus, the FSC warns that consumers may miss out on building a credit history, particularly those with a limited credit history, and make their payments on time. On the other hand, consumers who miss their payments may face severe negative consequences on their credit because debts in collection can be reported to consumer credit bureaus. Lastly, since these products may give companies access to sensitive consumer financial data, the FSC warns that emerging fintech credit products also raise concerns about data privacy and consumer cybersecurity.[195]

As indicated above, the Task Force on Financial Technology of the FSC heard from five industry witnesses who addressed several key areas, including current federal and state consumer protection regulations that apply to BNPL products. Among them, The Brookings Institution Fellow, Dr. Kristen E. Broady, highlighted the positive impact that fintech companies have in helping mitigate racial, financial health, and wealth gaps. Dr. Broady noted that, through technology and automation, fintech companies can reduce costs and prices, speed up delivery and increase convenience for underserved populations. Additionally, fintech companies provide new ways to capture data, reach broader audiences, and expand access to credit.[196] Among these companies, BNPL providers allow consumers to make purchases and split the cost, without paying any interest or impacting their credit score. This allows consumers to try items before they pay for them and only pay for items they keep.[197]

Another witness - Financial Technology Association CEO Penny Lee - outlined the benefits that BNPL products and services can bring to consumers. Ms. Lee noted that consumers prefer BNPL products relative to traditional credit options for several reasons, including because BNPL products: (1) have a lower cost, since they charge little or no interest or fees (different from credit cards, which according to recent data make the majority of their revenue from interest charges and have been found to cost vulnerable consumers up to 225% of the product purchase value in interest expenses);[198] (2) are more transparent, helping consumers better understand and control their finances; (3) help users budget and better manage their cash flows and avoid risky debt products; (4) are more flexible and offer more relief when consumers have an emergency; and (5) result in less debt and their repayments take place over shorter terms.[199] In addition, BNPL products are structured to have payment terms that require consumers to pay for a purchase over a few weeks or months, unlike revolving credit and high-interest products

[193] Ibidem (and accompanying notes 40 - 43).
[194] Ibidem (and accompanying notes 44 and 45).
[195] Ibidem (and accompanying notes 46, 47 and 48).
[196] See, Kristen E. Broady (Fellow, Metropolitan Policy Program, The Brookings Institution), Written Testimony submitted to U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, cit., p. 4.
[197] Id., p. 5.
[198] See, Penny Lee (CEO, Financial Technology Association), Testimony before the U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, cit., p. 2 (and accompanying note 4).
[199] Id., p. 2.

(which may take much longer to pay down, may blur the cost impact of a purchase, and could create a vicious cycle of debt for consumers due to continuous interest charges or rollovers).[200]

Ms. Lee noted that BNPL solutions can also provide significant value to merchants, by enhancing the customer experience, facilitating economic activity, driving higher conversion rates and increased sales, and improving customer satisfaction. She observed that a recent survey of 1,051 U.S. merchants shows that offering BNPL payment solutions to customers can improve customer experience and increase sales.[201] Another recent survey indicates that merchants using a particular BNPL solution can enjoy up to 13% more new customers.[202] More and more merchants have begun to offer various BNPL solutions along with traditional credit and debit payment options, citing customer demand, increasing total business sales, and expanding customer choice as key drivers for this decision.[203]

Ms. Lee emphasized that BNPL products are subject to key consumer protection regulations and that Financial Technology Association members are committed to informing regulatory frameworks that safeguard consumers. Although there is evidence of the benefits BNPL provides, she noted that the Financial Technology Association recognizes it is still early in the development of this space and that it is important to remain vigilant against unscrupulous actors or products that drive poor consumer outcomes. The Financial Technology Association supports partnering with policymakers to increase the understanding of how consumers use BNPL products and the impact of BNPL solutions on their financial well-being. Ms. Lee acknowledged the importance of anchoring future policy to a proper analysis of real-world outcomes (including with respect to credit reporting, financial health, and consumer choice and preferences) and adopting a balanced and thoughtful regulation that benefits consumers and merchants using BNPL solutions.[204]

Lastly, Ms. Lee noted that the Financial Technology Association members are engaged in active discussions with credit reporting agencies to ensure scoring models adequately account for BNPL products, are working with credit bureaus on ways to share repayment data, are actively pursuing real-world research to better understand economic impact and outcomes,[205] and are committed to advancing industry standards that safeguard consumers, including transparent and consistent disclosures.[206]

Another witness - Director of the California Policy Center for Responsible Lending, Marisabel Torres - focused her testimony on the key risks created by BNPL products and services on a large and growing scale. Ms. Torres noted that the BNPL market has exploded over the last year or two, with data suggesting BNPL increased anywhere from 200% to 350% between 2020 and 2021,[207] and over 42% of American consumers used BNPL products.[208] As the valuations of major BNPL firms are increasing to tens of billions of dollars, projections show BNPL reaching 10% of all e-commerce dollar volume by 2024.[209]

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[200] Id., p. 3.
[201] Ibidem (and accompanying footnote 5).
[202] Ibidem (and accompanying footnote 6).
[203] Ibidem.
[204] Id., p. 4.
[205] Id., pp. 4 and 5 (and accompanying note 8).
[206] Id., p. 5.
[207] See, Marisabel Torres (Director, California Policy, Center for Responsible Lending), Testimony before the U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, cit., p. 3 (and accompanying note 4).
[208] Ibidem (and accompanying note 6).
[209] Id., p. 4 (and accompanying note 7).

Ms. Torres observed that BNPL lenders generally verify identity and require a debit card or credit card to make payments and only run "soft" credit checks. This, in turn, creates the risk that BNPL loans may not be meaningfully underwritten for ability-to-repay, resulting in unaffordable loans. Ms. Torres argued that several factors provide clear evidence for this concern, including relatively high rates of BNPL bad debts and delinquency.[210] The consequences of unaffordable BNPL loans can be severe. As indicated by Ms. Torres, the lack of any substantial credit underwriting processes may result in BNPL providers extending credit to consumers who may not have sufficient funds and are therefore exposed to overdraft fees when BNPL payments are automatically withdrawn from their bank accounts. Alternatively, if sufficient funds are available, consumers may be left without sufficient funds for other essential living expenses or debts following the repayment of BNPL credit. Lastly, some BNPL providers may charge their own late or returned payment fees in addition to the fees charged by banks.[211]

Ms. Torres noted that the BNPL business model is driven by BNPL lenders' relationships with merchants and may create the wrong incentives for consumers to purchase items they would not otherwise buy, which is concerning in and of itself and even more so when coupled with the lack of underwriting for the affordability discussed above.[212] Ms. Torres argued that merchants might also seek to pass the fees they pay to BNPL lenders onto the consumers through hidden charges via inflated prices and/or extra fees on BNPL purchases. Additionally, increased competition in the BNPL market may drive merchant fees down, thus creating the risk that BNPL providers may try at some point to shift costs to consumers to make up the difference through interest rates or additional fees, for example by more aggressively pushing purchase volume with limited or no affordability assessments, and/or applying new charges or increasing existing late fees.[213]

Ms. Torres pointed out that BNPL credit does not provide dispute protections, and product returns can be complicated to manage. Additionally, most BNPL providers do not report repayment to credit reporting agencies, and therefore BNPL solutions do not typically enable people to build or improve credit scores. When BNPL providers report late payments to credit bureaus, those late payments may negatively affect credit history. Moreover, because of the lack of reporting, regulated providers that utilize credit reports currently have little or no insight into whether an applicant has multiple outstanding BNPL transactions and may not be able to see a BNPL borrower's full credit picture, thus complicating their ability to make informed credit assessments.[214]

Ms. Torres raised concerns that BNPL may be particularly burdening for young people who may take unaffordable debt, with long-term negative consequences. Moreover, to the extent BNPL loans are underwritten, the process is mostly, if not entirely, algorithmically driven, and thus subject to algorithmic bias.[215]

Regardless of whether BNPL is subject to TILA, Ms. Torres argued that CFPB has broad authority to identify and address risks that BNPL products pose to consumers and should therefore engage in active

[210] Id., pp. 5 and 6.
[211] Id., p. 7.
[212] Id., pp. 7 and 8.
[213] Id., pp. 8 and 9.
[214] Id., pp. 10 and 11.
[215] Id., p. 11.

oversight of BNPL lenders. In light of this, she urged the CFPB to: (i) in the near term, use its market monitoring authority to collect, analyze, and publish (anonymized) data from the largest providers to better identify risks within the market; (ii) subsequently issue a larger participant rule to define the market and then actively supervise large BNPL lenders to ensure that they are not engaged in unfair, deceptive, or abusive acts or practices or unlawful discrimination; and (iii) ensure that BNPL lenders make loans only after determining the borrower's ability to repay (considering both income and expenses or obligations), do not charge unfair fees, provide borrowers with the rights to dispute transactions and to obtain refunds analogous to those provided to credit card users, and do not violate the Electronic Fund Transfer Act's prohibition of conditioning the extension of credit on preauthorized electronic transfers. Lastly, Ms. Torres encouraged state regulators to require BNPL lenders to obtain state licenses and to consider collecting data to better investigate the risks involved in BNPL programs.[216]

A further witness - National Consumer Law Center Associate Director Lauren Saunders – observed that BNPL products can help consumers manage larger purchases without the long-term debt and high costs of credit cards if they are affordable and accessible to consumers.[217] However, Ms. Saunders acknowledged that BNPL may also pose significant risks. Some BNPL products may have deceptive and abusive profit models built on the expectation of late fees from struggling consumers, who may be led to take on debts they cannot afford to repay and may face significant challenges managing frequent BNPL payments.[218] Additionally, BNPL products do not generally report payments to credit bureaus, and as such they cannot help consumers build access to traditional credit. On the other hand, late or defaulted BNPL payments may be reported, thus potentially negatively impacting consumers who miss payments.[219] Consumers may also struggle to obtain refunds or redress without the dispute rights that credit cards typically have.[220] Lastly, it may not always be clear whether the data and information that BNPL providers collect from consumers are being used or shared in ways that consumers do not expect and would not allow, and the BNPL providers' business models may become increasingly focused on collecting, processing and monetizing data, and/or pitching other products.[221]

Ms. Saunders argued that BNPL products may not currently receive adequate oversight. Although in some States BNPL providers are subject to licensing requirements and banks that offer BNPL products are subject to supervision, non-bank BNPL players are not presently supervised at the federal level.[222]

Given the dramatic growth in the BNPL market and the potential impact on consumers, Ms. Saunders expressed the view that newer financing and cash flow products (including BNPL) should be viewed as credit and subject to federal and state lending and fair laws. She encouraged regulators to closely examine and take actions on evasive pricing models built on "tips," late fees, or inflated "expedite" fees and models targeted at struggling consumers or designed to result in a cycle of debt. Additionally, she stressed that POS credit should have the same chargeback, reasonable and proportional penalty fees, ability-to-

[216] Ibidem.
[217] See, Lauren Saunders (Associate Director, National Consumer Law Center), Testimony before the U.S. House of Representatives Committee on Financial Services, Task Force on Financial Technology, cit., pp. 4-6.
[218] Id., pp. 6 and 7 (and accompanying notes 12, 13 and 14).
[219] Ibidem.
[220] Id., pp. 8 and 9.
[221] Id., pp. 17 and 18.
[222] Id., p. 9.

repay, and statement requirements that apply to credit cards. She then concluded by noting that data should be used in ways consumers expect and that regulators should keep an eye out for inappropriate collection, use, and safeguarding of data, and update inadequate privacy laws.[223]

2.5 The U.S. Senate Banking Committee's Letter to CFPB Director Rohit Chopra (December 2021)

In a letter sent to CFPB Director Rohit Chopra dated December 15, 2021, six U.S. senators urge the CFPB to take action under its existing authorities to protect consumers against BNPL providers that operate without oversight.[224] The senators assert that some BNPL companies deliberately structure their products to avoid consumer protection obligations under the TILA or other lending laws, which apply to loans that are repayable in more than four installments or are subject to a finance charge.[225]

The senators acknowledge that the BNPL market has experienced extraordinary growth over the last two years, which has been accelerated by the Covid-19 pandemic driving more consumers to shop online and through mobile apps and by merchants who have increasingly utilized BNPL solutions to drive sales from consumers wary of credit cards. This trend – they argue - is likely to continue.[226]

Although the emergence of BNPL as affordable small-dollar credit has offered an alternative to more costly forms of credit, the six lawmakers warn that BNPL products also have the potential to cause consumer harm. For instance, BNPL products do not typically receive the protections credit cards have, including those relating to the ability to repay, monthly statements, reasonable and proportional penalty fees, and the ability to raise merchant-related disputes. [227]

In pointing out that non-bank BNPL providers currently operate without meaningful oversight and are not generally subject to federal supervision that can identify unfair, deceptive, or abusive practices or other violations of federal consumer protection laws, the six U.S. senators express the concern that the regulatory gap for BNPL can lead to three main negative consequences: [228] (i) consumers may not fully appreciate the risks associated with obtaining BNPL credit due to the lack of consolidated account statements, varying repayment schedules, as well as the absence of information and standardized disclosures about late fees and the consequences of missed payments and default;[229] (ii) consumers who

[223] Id., pp. 3 and 4.
[224] See, U.S. Senate Committee on Banking, Housing, and Urban Affairs, Letter to the Honorable Rohit Chopra, Director Consumer Financial Protection Bureau (December 15, 2021); U.S. Senate Committee on Banking, Housing, and Urban Affairs, U.S. Senators Urge CFPB to Take Action to Ensure Transparency & Oversight of Buy Now Pay Later Products & Providers, Press Release (December 15, 2021).
[225] See, U.S. Senate Committee on Banking, Housing, and Urban Affairs, Letter to the Honorable Rohit Chopra, Director Consumer Financial Protection Bureau, cit., p. 1.
[226] Ibidem.
[227] Ibidem.
[228] Id., p. 2.
[229] Ibidem (noting "[i]n the absence of consolidated account statements, confusion about repayment schedules and consequences of default can lead to missed payments and associated late fees. Lack of standardized disclosures can also create potential for hidden fees and expenses. Marketing through retailers' websites and mobile apps compound this problem by advertising BNPL products as available at "no cost" or with "no interest." That can create a misperception that credit is truly free. Consumers are also exposed to risk of overdrafts because they typically repay BNPL credit through automatic withdrawals from bank accounts or payment via debit cards"). Interestingly, the senators writing to the CFPB seem to suggest that retailers that offer BNPL programs may themselves be exposed to some share of the responsibility and liability in relation to potentially misleading marketing and advertising activities.).

take advantage of BNPL offers may not have the ability to repay BNPL credit; [230] and (iii) on-time BNPL payments are not usually reported to the credit bureaus, but delinquencies or defaults may be, and this can make it difficult for consumers to use BNPL to build positive credit history.[231]

2.6 The CFPB's Market Monitoring Orders Inquiring into BNPL (December 2021)

On the heels of the letter sent by the U.S. Senate Banking Committee to CFPB Director Rohit Chopra discussed in the prior section, on December 16, 2021, the CFPB issued a series of market monitoring orders, requiring five leading companies offering BNPL products in the United States (Affirm, Afterpay, Klarna, Paypal, and Zip) to provide information about their size, scope, and business practices by March 1, 2022.[232] The CFPB plans to publish aggregated findings and insights learned from this inquiry. [233]

Commenting on the orders, CFPB Director Rohit Chopra indicated that BNPL is the "new version of the old layaway plan, but with modern, faster twists" where the consumer "gets the product immediately but gets the debt immediately too." [234]

In the accompanying press release, the CFPB notes that BNPL is a deferred payment option that allows the consumer to divide a purchase cost into smaller installments (typically four or fewer), often with the first payment of 25% at checkout. The application process is quick, involving relatively little information from the consumers, who usually pay no interest. The CFPB further observes that lenders have increasingly offered BNPL credit as a safer alternative to credit card debt and a unique opportunity to serve consumers with scant or subprime credit histories. Merchants typically pay between 3 to 6% fees to BNPL providers and are generally willing to do so because consumers often spend more and buy more with BNPL offers. The CFPB notes the explosive growth of BNPL products, which has driven increased investor appetite in this space (including significant venture capital funding) and has fostered competition, with big tech companies entering the BNPL market in recent months. [235]

The CFPB highlights that the inquiry is intended to gather insights and help the CFPB educate itself and the public on the range of BNPL solutions and their underlying business practices, how consumers interact with BNPL providers, and how BNPL business models impact the broader e-commerce and consumer credit marketplaces, and potential risks and concerns. [236] In the orders, the CFPB also notes that it reserves the right to use the information collected through the inquiry for any purposes permitted by law,[237] which may include rulemaking or enforcement to the extent that the CFPB finds violations of

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[230] Ibidem (noting "[n]on-bank providers typically do not engage in rigorous underwriting practices. They conduct only a "soft" inquiry on a consumer's credit for the limited purposes of verifying a consumer's identity and preventing fraud. Even multiple BNPL loans will not typically appear on a consumer's credit report. This can lead to elevated levels of indebtedness because consumers may have multiple outstanding transactions across different providers that together add up to a high overall balance.")
[231] Ibidem, noting ("[e]ven if positive payments were reported, those payments might actually reduce a consumer's credit score by lowering the average age of their credit accounts. BNPL users tend to be younger individuals without a long credit history. Negative credit history for young consumers can have effects later in life, making it harder to qualify for favorable rates when they seek to finance a car or a home.").
[232] See, Consumer Financial Protection Bureau (CFPB), Consumer Financial Protection Bureau Opens Inquiry into "Buy Now, Pay Later" Credit, CFPB Press Release (December 16, 2021); Consumer Financial Protection Bureau (CFPB), Sample Order to File Information, CFPB (December 2021).
[233] See, Consumer Financial Protection Bureau (CFPB), Consumer Financial Protection Bureau Opens Inquiry into "Buy Now, Pay Later" Credit, cit.
[234] Ibidem.
[235] Ibidem.
[236] Ibidem.
[237] See, Consumer Financial Protection Bureau (CFPB), Sample Order to File Information, cit., p. 1.

consumer financial-services laws. Whether or not these orders would lead to new regulation or enforcement, they sent a strong signal to BNPL market participants that the CFPB is questioning how consumers using BNPL products may face risks.

The CFPB lists six areas of specific interest in the orders: (a) business model and transaction metrics,[238] (b) loan performance metrics,[239] (c) consumer protections,[240] (d) user contacts and demographics,[241] (e) data harvesting,[242] and (f) data monetization. [243]

In the accompanying press release, the CFPB identifies the following key areas of concern: [244]

- Accumulating Debt - the CFPB raises concerns about consumers accumulating debt under BNPL programs. The CFPB notes that unlike traditional installment loans typically utilized for large purchases, consumers can quickly access BNPL solutions for everyday discretionary buying. It may be difficult for a consumer to keep track of required payments if the consumer ranks up multiple BNPL purchases with varying payment schedules and payment terms with various BNPL companies. When the consumer misses a BNPL payment, this can potentially result in the application of charges by both the consumer's bank and the BNPL provider. Because of the ease of accessing BNPL credit, the CFPB warns that consumers may end up overspending, not fully understanding the terms of their credit, and facing possible payment difficulties and associated fees and charges.
- Regulatory Arbitrage - the CFPB raises concerns that some BNPL companies may not adequately assess what consumer protection laws apply to their products and what associated requirements must be met, including in relation to disclosures. Moreover, the CFPB notes that protections that apply to credit cards may not apply to BNPL products, including dispute resolution protections. Different late fees and policies also apply.
- Data Harvesting - the CFPB observes that BNPL lenders have access to their customers' valuable purchase and payment information. Some BNPL lenders have leveraged this information to develop "closed-loop shopping" apps pushing products and services toward consumers, often younger audiences. The CFPB warns that BNPL lenders will need to find alternative revenue sources to maintain growth and profitability as competitive forces pressure the merchant discount. Therefore, the CFPB would like to better understand practices around data collection, behavioral targeting, data monetization, and the risks they may create for consumers by processing the data (including for targeted offers and advertising).

The CFPB concludes by noting that BNPL products have seen growth internationally and that many other countries are also closely examining BNPL providers and their products. The CFPB states that it

[238] Id., pp. 6 - 10.
[239] Id., pp. 11 and 12.
[240] Id., p. 12.
[241] Id., pp. 13 and 14.
[242] Id., p. 15.
[243] Id., pp. 15 and 16.
[244] See, Consumer Financial Protection Bureau (CFPB), Consumer Financial Protection Bureau Opens Inquiry into "Buy Now, Pay Later" Credit, cit.

is working closely with regulators in Australia, Sweden, Germany, and the United Kingdom and is coordinating with the rest of the Federal Reserve System and state authorities.[245]

The CFPB inquiry is a significant opportunity to gain transparency into the BNPL market. When contacted for comments about the CFPB's inquiry, Klarna noted that "proportionate regulation is a good thing,"[246] Affirm said that it "welcomes the CFPB's review and supports regulatory efforts that benefit consumers and promote transparency," [247]Afterpay indicated that it supports "efforts to ensure that there are appropriate regulatory protections for consumers" in relation to BNPL practices,[248] PayPal noted that it was reviewing the CFPB inquiry and would comply,[249] and Zip said it was "keen to co-operate with the CFPB and explain what [Zip] do[es], address any concerns and crucially how [Zip] treat[s] consumers responsibly."[250]

2.7 The CFPB's Notice and Request for Public Comment Regarding the CFPB's Inquiry into BNPL (January – March 2022)

On January 24, 2022, the CFPB published a notice in the Federal Register seeking public comments to inform its inquiry into BNPL products discussed in the prior section. The CFPB invited any interested party to submit their comments through the Federal Register by March 25, 2022.[251]

In a blog post published on January 12, 2022, the CFPB notes that some analysts have suggested that BNPL has rerouted big holiday shopping money away from credit cards, thus putting an enormous amount of consumer debt on BNPL providers' books.[252] As it did when the orders were first issued to the five leading BNPL providers in December 2021, the CFPB raises its concerns around some "systemic, underlying problems," particularly relating to accumulating debt, regulatory arbitrage, and data harvesting in a consumer credit market already quickly changing with technology. The CFPB also observes that regulators in other countries have taken an active interest in BNPL.[253]

In the Federal Register notice, the CFPB encourages the public to provide comments on BNPL products and offers the following examples of relevant issues: (a) the buyer experience with BNPL, (b) the benefits and risks of BNPL, (c) the merchant experience, (d) the perspectives that regulators and attorneys general have with respect to BNPL products, and (e) ways in which the BNPL market can be improved.[254]

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[245] Ibidem. See also, Goodwin Procter LLP, CFPB Targets "Buy Now, Pay Later" Industry, Goodwin Procter Publications (December 17, 2021); Morgan, Lewis & Bockius LLP, CFPB's Probe of Buy Now, Pay Later: What's the Risk to Consumers?, Bloomberg Law (February 15, 2022); Cooley LLP, Fintech Focus: CFPB Updates FAQs, Scrutinizes Buy Now, Pay Later Companies and Fintech Lending, Cooley Alert (December 23, 2021); Eversheds Sutherland (US) LLP, Focus on Fintech: The CFPB is Scrutinizing Buy Now Pay Later Products – is Rulemaking Next?, Eversheds Sutherland Insights (January 25, 2022).
[246] See, Hannah Lang and Katanga Johnson, U.S. CFPB asks 'buy-now, pay-later' companies for data on products, practices, Reuters (December 17, 2021).
[247] Ibidem.
[248] Ibidem.
[249] Ibidem.
[250] See, Imani Moise and Stefania Palma, US consumer watchdog probes 'buy now, pay later' companies, Financial Times (December 16, 2021).
[251] See, Consumer Financial Protection Bureau (CFPB), Notice and Request for Comment Regarding the CFPB's Inquiry Into Buy-Now-Pay-Later (BNPL) Providers, CFPB Press Release (January 24, 2022); Consumer Financial Protection Bureau (CFPB), Notice and Request for Comment Regarding the CFPB's Inquiry Into Buy-Now-Pay-Later (BNPL) Providers, Notice, Docket No. CFPB–2022–0002, Federal Register Vol. 87, No. 15 (January 24, 2022).
[252] See, Consumer Financial Protection Bureau (CFPB), Our public inquiry on buy now, pay later, CFPB Publications (January 12, 2022).
[253] Ibidem.
[254] See, Consumer Financial Protection Bureau (CFPB), Notice and Request for Comment Regarding the CFPB's Inquiry Into Buy-Now-Pay-Later (BNPL) Providers, Notice, Docket No. CFPB–2022–0002, cit.

The feedback and comments provided by the public will help the CFPB better understand how people interact with BNPL providers and how the BNPL providers' business models impact the broader e-commerce and consumer credit marketplaces.[255]

2.8 BNPL and State Regulators

The growing use of BNPL solutions has drawn increased scrutiny at the state level. State regulators have progressively raised consumer protection concerns regarding BNPL products and have been closely examining BNPL providers' practices, business models, and activities. Although existing state laws are not written to apply specifically to BNPL, BNPL providers may still fall under state licensing regimes for lenders and be subject to credit statutes and state laws prohibiting unfair, deceptive, or abusive acts or practices.[256]

Among the various States, California has been leading the way, with California regulators significantly intensifying their oversight of BNPL in recent years. As further discussed below, California regulators have classified certain BNPL solutions as 'loans,' have announced settlements with a few unlicensed high profile BNPL providers and have increasingly brought BNPL companies' activities and products under state lending rules.

On December 30, 2019, the California Department of Financial Protection and Innovation ("DFPI") (formerly, California Department of Business Oversight ("DBO")) denied an application by BNPL provider Sezzle to make loans under the California Financing Law ("CFL") after determining that Sezzle had engaged in illegal unlicensed lending in the State of California.[257]

In its defense, Sezzle argued that it had not previously applied for a license to lend in the State of California because it did not consider its financing product a "loan", instead it contended that it purchased credit sale contracts from merchants who sell goods to consumers and that those contracts did not constitute loans under California law and, thus, were not subject to the CFL.[258]

Under the CFL, third parties may purchase a merchant's non-evasive, *bona fide* credit sales contracts without such purchases necessarily subjecting the transactions to the State of California's loan laws.[259] However, extensive third-party involvement in the underlying credit sale may cause transactions to be deemed loans, regardless of the form.[260] Boerner v. Colwell Co. is the "seminal case differentiating a

[255] Ibidem. See, also, Consumer Financial Protection Bureau (CFPB), Our public inquiry on buy now, pay later, cit.
[256] See, e.g., Goodwin Procter LLP, Growing Regulatory Focus on Buy Now Pay Later, Goodwin Procter Webcast (December 10, 2021) (noting that non-bank lenders may be required to obtain lender licenses to offer BNPL. Although certain BNPL models rely on banking partnerships to potentially reduce the impact of state regulation application, BNPL arrangements cannot escape regulatory scrutiny entirely and bank partnerships may not eliminate license requirements depending on the activities being performed by the parties); Venable LLP, Buy-Now-Pay-Later: A 360 Degree Overview, Venable Insights (January 25, 2022).
[257] See, California Department of Financial Protection and Innovation (DFPI) (formerly the California Department of Business Oversight (DBO)), DBO Denies Lending License Sought by Unregulated Point-of-Sale Financer and Issues Related Legal Opinion, DFPI Press Release (December 30, 2019); In re Sezzle, Inc., Statement of Issues, CFL File no. 60DBO-104155 (December 30, 2019).
[258] In re Sezzle, Inc., Statement of Issues, cit., p. 2.
[259] Id., pp. 3 and 4.
[260] Id., p. 5.

credit sale from a loan," setting the boundary of permissible third-party involvement in an otherwise non-evasive, *bona fide* credit sale.[261]

The DFPI noted that although no court in California had considered whether transactions like those structured and marketed by Sezzle are loans, the common law provides three pertinent principles in evaluating third-party participation when considering the substance of a transaction.[262] Specifically, a transaction may be considered a loan, despite its form, if: (i) the third party's involvement with the merchant goes beyond that necessary to effectuate the purchase of credit sales; (ii) the role of the third party and the terms of the transaction are not fully disclosed to the consumer; and (iii) the third party does not bear the full risk of consumer performance under the credit sale.

Within that framework and following a review of Sezzle's products and additional information provided by Sezzle in connection with its application, the DFPI determined that Sezzle was making unregulated loans to California consumers in violation of the CFL.[263] The DFPI concluded that the purported credit sales made by Sezzle's merchant partners were not *bona fide* but, rather were structured to evade otherwise applicable consumer protections.[264] In particular, the DFPI found that Sezzle had an extensive role in its merchants' transactions and pre-existing relationships with some consumers who were parties to the purported credit sales.[265] The DFPI also noted that consumers using Sezzle were not fully informed of the role of Sezzle or all financing terms. Sezzle was reserving the right to unilaterally impose new fees on consumers and did not disclose the fees paid by the merchants.[266] Lastly, the DFPI found that Sezzle did not bear the full risk of loss from performance on the credit sales contracts it purchased. The merchant agreements adopted by Sezzle provided Sezzle with an opportunity to review and refuse the financing for certain consumer purchases, despite the sales having already been processed by the merchants.[267]

In a parallel action on December 20, 2019, the DFPI issued an interpretive opinion advising an unnamed lender that its deferred payment products were meeting the Civil Code and case law definition of "loans" and therefore required a CFL license in California.[268] In the interpretive opinion, the DFPI acknowledges that the requestor's deferred payment products are similar to retail installment sales contracts (which are not "loans"). But, the DFPI ultimately concludes that the substance of the transaction at issue is a "loan"

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[261] See, Front Line Motor Cars v. Webb (2019) 35 Cal.App.5th 153, 164 (2019) (referring to Boerner v. Colwell Co., 21 Cal. 3d 37 (1978)).
[262] See, In re Sezzle, Inc., Statement of Issues, cit., pp. 5 and 6.
[263] Id., pp. 6 - 10.
[264] Id., pp. 6 and 7 (noting that "Sezzle markets its financing products to consumers before the consumers have decided to shop at a particular merchant or to purchase a particular product. Sezzle encourages its users to only shop at merchants who accept Sezzle. …Sezzle's consumers and merchants do not enter into contracts with each other. There is no existing contract for Sezzle to purchase, and there is no manifested intent from merchants to make sales on credit to consumers." In examining Sezzle's contracting process, the DFPI pointed out that "[c]onsumers can establish an account with Sezzle in advance of any purchase or any visit to a merchant website. To create an account, consumers must agree to the Sezzle User Agreement (User Agreement) … The User Agreement is between Sezzle and its users. Sezzle's merchants are not parties to the User Agreements. The User Agreement is a non-negotiable, clickthrough agreement, subject to unilateral changes post-execution by Sezzle. The User Agreement is changed by Sezzle often." Significantly, the DFPI noted that Sezzle User Agreement contained multiple references to Sezzle providing direct consumer financing to consumers.).
[265] Id., p. 8 (point out that "Sezzle's involvement with its merchants goes well beyond any non-lending relationship yet permitted by California courts, and the credit sales purportedly purchased by Sezzle do not justify Sezzle's extensive involvement … In addition to purportedly purchasing merchants' credit sales contracts, Sezzle provides its merchants marketing services, payment processing services, consumer dispute resolution services, and interest-bearing accounts in which merchants can park the revenue earned from Sezzle.").
[266] Id., p. 8.
[267] Ibidem.
[268] See, California Department of Financial Protection and Innovation (DFPI) (formerly the California Department of Business Oversight (DBO)), Interpretative Opinion on Deferred Payment Products (December 20, 2019).

based on its analysis of various factors, including the following: (i) the intent of the parties (consumer, merchant, and third-party financer), who may treat the transactions like loans, despite contradictory language in the applicable contracts; (ii) whether the merchant and third party are closely related or have a preexisting relationship; (iii) whether the third party assumes the contract at the POS or later; (iv) whether the third party underwrites the transaction, and determines eligibility for the contract; and (v) whether the transaction would be regulated under another law.[269]

Shortly after that, between January and April 2020, the DFPI entered into a sweep of settlements involving leading BNPL companies Sezzle,[270] Afterpay [271] and Zip (formerly Quadpay)[272] for making loans in California without obtaining the required license. The DFPI found that the lenders' practices of purchasing purported credit sales contracts from merchants (rather than registering as consumer finance lenders and explicitly lending themselves) were structured to evade otherwise applicable consumer protections. In addition to paying civil penalties and administrative fees, these BNPL companies agreed to refund California consumers for an aggregate amount of c. $1.9 million, obtain licenses, and comply with applicable lending laws. Each of them entered into a consent order with the DFPI without admitting or denying that they engaged improperly in the business of a finance lender in California.

More recently, on October 7, 2021, the DFPI published its 2020 Annual Report of Finance Lenders, Brokers and PACE Administrators Licensed under the California Financing Law ("DFPI 2020 Annual Report").[273] The DFPI 2020 Annual Report examines unaudited data gathered from several finance lenders, brokers, and Property Assessed Clean Energy (PACE) administrators licensed under the CFL, as well as new data from the BNPL industry.

The DFPI 2020 Annual Report shows a sharp decrease in some types of consumer loans and a rapid surge in others, thus underscoring a relevant change in consumer behavior. It also evidences a surge in BNPL unsecured consumer loans reported to the DFPI, showing that BNPL payment options are becoming increasingly popular, are growing dramatically in volume, and are becoming a more significant percentage of the DFPI's portfolio under CFL. The DFPI indicates that finance lenders (including BNPL providers) originated almost 12 million consumer loans in 2020, a 530.2% increase from 2019. The total principal amount of loans increased by 96.8%, from $57 billion in 2019 to $112.2 billion in 2020.

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[269] Id., pp. 2 - 4.

[270] See, California Department of Financial Protection and Innovation (DFPI) (formerly the California Department of Business Oversight (DBO)), Point-of-Sale Lender Sezzle Agrees to Cease Illegal Loans, Pay Refunds in Settlement with the California Department of Business Oversight, DFPI Press Release (January 16, 2020); In re Sezzle, Inc., Consent Order, CFL File no. 60DBO-104155 (January 16, 2020).

[271] See, California Department of Financial Protection and Innovation (DFPI) (formerly the California Department of Business Oversight (DBO)), Point-of-Sale Lender Afterpay Agrees to Cease Illegal Loans, Pay Refunds in Settlement with the California Department of Business Oversight, DFPI Press Release (March 16, 2020); In re Afterpay US, Inc., Consent Order (March 16, 2020).

[272] See, California Department of Financial Protection and Innovation (DFPI) (formerly the California Department of Business Oversight (DBO)), Point-of-Sale Lender QuadPay Agrees to Cease Illegal Loans, Pay Refunds in Settlement with the California Department of Business Oversight, DFPI Press Release (April 22, 2020); In re QuadPay, Inc., Consent Order, CFL File no. 60DBO-110414 (April 22, 2020).

[273] See, California Department of Financial Protection and Innovation (DFPI), DFPI Report Shows Changes in Consumer Lending, Decrease in PACE Program, DFPI Press Release (October 7, 2021); California Department of Financial Protection and Innovation (DFPI), Annual Report of Finance Lenders, Brokers, and PACE Administrators Licensed Under the California Financing Law, DFPI Report (October 2021).

Interestingly, the top six BNPL lenders accounted for almost 11 million of those loans, representing c. 91% of the total consumer loans originated in 2020.[274]

In the accompanying press release, DFPI Acting Commissioner Christopher S. Shultz noted that "… consumer behavior likely changed as a result of a myriad of factors, including state and federal cash assistance, moratoriums on student loan payments, rental and mortgage relief assistance related to the pandemic, and favorable interest rates for the real estate market. The report also includes new data from the Buy Now, Pay Later industry."[275]

The accompanying press release also references recent DFPI's enforcement actions and settlement activity with Sezzle, Zip, and Afterpay as indicated above and confirms that these BNPL companies are now licensed lenders with the State of California, are subject to rate and fee caps, must consider consumers' ability to repay loans, and must respond to consumer complaints.[276]

While California has taken the lead in state regulatory actions, other States are expected to follow suit. Several States are now monitoring BNPL activities and gauging consumer protection concerns. Some States are weighing how to regulate BNPL products and are reviewing their lender licensing laws to determine whether those laws apply to BNPL providers. Other States are contemplating further action in this space, including creating state statutes that provide regulatory oversight to BNPL.[277] Recent actions also open the possibility that certain state financing laws may be expanded beyond BNPL providers to cover retailers as well, depending on how the BNPL arrangements are structured.

[274] See, California Department of Financial Protection and Innovation (DFPI), Annual Report of Finance Lenders, Brokers, and PACE Administrators Licensed Under the California Financing Law, cit., p. 2.
[275] See, California Department of Financial Protection and Innovation (DFPI), DFPI Report Shows Changes in Consumer Lending, Decrease in PACE Program, cit.
[276] Ibidem.
[277] See, Elaine S. Povich, Regulators Scrutinize Buy Now, Pay Later Plans, The Pew Charitable Trusts Insights (February 2, 2022) (noting "[a] spokesperson for the Oregon Division of Financial Regulation, Mark Peterson, wrote in an email that the department is continuing to "monitor these sorts of financing options for consumers and gauge consumer protection concerns. We are a part of several [state] regulatory organizations that are contemplating further action in this space, such as the creation of state statutes that provide regulatory oversight to these sorts of options." […] Lucinda Fazio, director of consumer services at the Washington State Department of Financial Institutions, said whether buy now, pay later firms constitute loan companies is difficult to assess. […] Massachusetts requires small loan companies and retail installment finance companies to have a state license. The state classifies Affirm as a small loan company, but had not classified the other large buy now, pay later companies in any way as of Oct. 1, the latest date for which a list is available.").

CHAPTER 3

THE EVOLVING REGULATORY FRAMEWORK OF BNPL IN THE UNITED KINGDOM

BNPL products have rapidly increased in usage and popularity in the United Kingdom in recent years. This has led to a corresponding increase in scrutiny from UK regulators over concerns that BNPL providers and their activities and products may not be sufficiently regulated.

At present, firms that offer BNPL products in the United Kingdom benefit from an exemption from regulation under Article 60F(2) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("RAO"), which allows them to offer BNPL credit on an unregulated basis if the following conditions are met: (i) the agreement is a borrower-lender-supplier agreement, (ii) the agreement is for credit of a fixed sum, (iii) the number of payments to be made by the borrower does not exceed twelve, (iv) the payments are required to be made within twelve months of commencement of the agreement, and (v) the credit is provided without interest or other charges.[278]

That is likely to change, however. In fact, following an in-depth review of change and innovation in the UK unsecured credit market commissioned by the Financial Conduct Authority ("FCA") published in 2021, the HM Treasury announced plans to regulate BNPL lending and opened a public consultation for BNPL rules which closed in early 2022. This consultation will be followed by a consultation by the FCA, with the new regulatory framework expected to be adopted in late 2022 or 2023. Although at the date of writing the HM Treasury and the FCA have not yet announced their next steps, it is likely that they will chart a measured course of action and that new rules will be based on the principle of "proportionate regulation" intended to target consumer detriment and address relevant risks posed by BNPL, while also promoting innovation and maintaining consumer access to BNPL. The UK regulators' efforts are expected to focus on two main concerns – the lack of clear and complete disclosures regarding the nature and financial impact of BNPL credit, and the deficiencies and inconsistencies in creditworthiness assessments (comprising both credit risk and affordability).

Pending the adoption of new regulation, the FCA has continued using its consumer protection powers outside of the UK consumer credit regime to assess the fairness and transparency of the terms of BNPL products. In parallel, the Committee of Advertising Practice ("CAP") and the Advertising Standards Authority ("ASA") have made several interventions relating to the advertising of BNPL products, designed to ensure consumers understand BNPL offerings amount to credit and aren't encouraged to use BNPL products irresponsibly.

This chapter explores these recent regulatory developments and the impact of impending regulation of BNPL in the United Kingdom.

[278] In the United Kingdom, unsecured consumer credit is regulated under the framework provided by the Consumer Credit Act 1974 ("CCA") and the Financial Services and Markets Act 2000 ("FSMA"). The scope of regulation is set out in detail in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("RAO"). Firms that offer regulated credit agreements must be authorized to do so by the Financial Conduct Authority ("FCA") and must comply with relevant FCA rules as well as requirements in the CCA. The RAO provides for some exemptions from regulation so that not all forms of credit are regulated. These include an exemption for interest-free credit set out in article 60F(2) of the RAO discussed above. In addition to BNPL products, a range of financial credit arrangements rely on this exemption, including higher-value consumer goods and invoice financing, which predate the expansion of BNPL.

3.1 The FCA's Consultation Papers 18/12 and 18/43 and Policy Statement 19/17 on BNPL (May 2018 – June 2019)

On May 31, 2018, the FCA published a consultation paper on high-cost credit ("CP 18/12"), which contains proposed rules and guidance relating to catalogue credit and store cards, including some proposals in relation to BNPL offers.[279] In the CP 18/12, the FCA expresses its intent to take a broader look at the use of BNPL offers in the wider credit market and to assess whether further measures would be appropriate.

On December 18, 2018, the FCA issued a further consultation paper on high-cost credit ("CP 18/43") where it confirms its measures in relation to catalogue credit and store cards and invites comments on a package of additional measures relating to BNPL offers.[280] These measures include:

- Three proposed disclosure remedies, designed to improve the information consumers receive about BNPL offers; and
- A proposal to prevent firms from charging backdated interest on money that the consumer has repaid during the BNPL offer period.

In the CP 18/43, the FCA notes that a range of firms offers BNPL as part of their credit offers. These include catalogue credit, store cards, and retailers that offer finance at the point of sale (in-store or online). The credit is provided either by or on behalf of a retailer to enable a consumer to buy something specific (sometimes referred to as "retail finance"). BNPL solutions tend to provide a promotional period, typically up to twelve months, during which consumers are not charged interest. However, if the consumer does not repay the entire amount within this period, interest will usually be charged from the date of purchase. Consumers who repay part but not all the amount owed are still charged backdated interest on that part.[281] The FCA estimates that c. 3 million consumers used BNPL products in 2016, of which c. 50% did not repay their full balance before their promotional period ended, thus incurring interest charged from the date of purchase.[282]

On June 12, 2019, the FCA published a policy statement ("PS 19/17") summarizing the feedback received in response to its consultation and announcing the introduction of new rules in the BNPL sector designed to reduce the harm experienced by some consumers who buy products using BNPL credit offers.[283]

The key proposals confirmed in the PS 19/17 provide that BNPL firms:

- cannot charge backdated interest on amounts of money that the consumer has previously repaid during the BNPL offer period;

[279] See, Financial Conduct Authority (FCA), High-cost Credit Review: Consultation on rent-to-own, home-collected credit, catalogue credit and store cards, and alternatives to high-cost credit. Discussion on rent-to-own pricing, FCA Consultation Paper (CP 18/12) (May 2018); Financial Conduct Authority (FCA), CP18/12 and CP18/13: Consultations on High-cost Credit and on Overdrafts, FCA Publications (May 31, 2018).
[280] See, Financial Conduct Authority (FCA), High-cost Credit Review: Feedback on CP18/12 with final rules and guidance and consultation on Buy Now Pay Later offers, FCA Consultation Paper (CP 18/43) (December 2018).
[281] Id., pp. 40 and 41.
[282] Id., p. 41.
[283] See, Financial Conduct Authority (FCA), Buy Now Pay Later offers – feedback on CP18/43 and final rules, FCA Policy Statement (PS 19/17) (June 2019); Financial Conduct Authority (FCA), FCA publishes final rules on Buy Now Pay Later products, FCA Press Release (June 12, 2019); Financial Conduct Authority (FCA), PS19/17: Buy Now Pay Later offers – feedback on CP18/43 and final rules, FCA Publications (June 12, 2019).

- must provide better information to consumers about BNPL offers. The information should be more balanced and should appropriately reflect the risks as well as the benefits of the BNPL product; and
- must give prompts to consumers to remind them when the offer period is about to end, so that consumers are more likely to repay their BNPL credit before incurring interest or other charges.

The disclosure rules and guidance came into force on September 12, 2019, while the rule preventing backdated interest from being charged on repaid amounts entered into effect on November 12, 2019.[284]

In commenting on the new measures, Christopher Woolard, FCA Executive Director of Strategy and Competition, said "[s]ince taking over regulation of consumer credit in 2014, [the FCA's] interventions have made a real difference to consumers, especially to people who use high-cost credit. The changes [the FCA is] announcing today in the BNPL sector build on these interventions. They are intended to simplify these products and make it easier for consumers to make informed decisions … The rules [the FCA] will be implementing will not only improve the information consumers receive about BNPL offers, but will stop firms from charging backdated interest on sums repaid during the offer period. [The FCA] expect[s] the overall package of measures will save consumers around £40-60 million a year and tackle the harm [the FCA] identified in this market … [the FCA] will intervene where [it] sees harms and [it] remains vigilant in this and other sectors." [285]

In the PS 19/17, the FCA notes that simplicity and clearer information should help consumers make more informed decisions and use the BNPL products better. This, in turn, may enable more consumers to pay back their debt during the BNPL offer period in full or in large part, thus incurring less interest and repaying their debt more quickly.[286]

In relation to the package of disclosure remedies intended to enhance the quality of the information provided to consumers, the FCA confirms the following:

- The extension of the rule on adequate explanations previously made in relation to catalogue credit and store card providers (CONC 4.2.15R (8)) to all BNPL firms. The rule requires firms to disclose to their customers the method by which they will be charged interest if they fail to repay within the BNPL offer period. An adequate explanation should be provided to the customer before the agreement is made.[287] In addressing the feedback provided by respondents to the consultation, the FCA acknowledges that information needs to be clear and comprehensible. However, the FCA does not consider it necessary to require BNPL firms to use a prescribed format or include worked examples. Firms should have the flexibility to tailor

[284] See Financial Conduct Authority (FCA), Buy Now Pay Later offers – feedback on CP18/43 and final rules, FCA Policy Statement (PS 19/17), cit., pp. 4 - 7 (noting "the FCA received 13 responses to CP 18/43, from consumer groups and industry respondents. There was broad support for the 3 disclosure measures, both from consumer groups and industry respondents, including the proposed 3-month implementation period. In addition, consumer groups supported the proposal to prevent firms from charging backdated interest on amounts that have been repaid during the offer period, whilst industry respondents strongly opposed this proposed measure and the proposed implementation period of 3 months from the date the rules are published. The FCA carefully considered the arguments made and confirmed its intent to proceed with the measure as consulted on, but extended the implementation period of the partial repayment rule by 2 months to give firms sufficient time to make the necessary changes.").
[285] See, Financial Conduct Authority (FCA), FCA publishes final rules on Buy Now Pay Later products, FCA Press Release, cit.
[286] See, Financial Conduct Authority (FCA), Buy Now Pay Later offers – feedback on CP18/43 and final rules, FCA Policy Statement (PS 19/17), cit., pp. 5 and 6.
[287] Id., pp. 9 and 10.

their communications for their customers, bearing in mind that different customers react to different forms of disclosure.[288] Information provided to consumers should be more balanced and reflect the risks and benefits of the relevant BNPL products, and consumers should be clearer about the implications of not repaying the full balance by the end of the offer period.

- The extension of the rule on prompts previously made in relation to catalogue credit and store card providers (CONC 6.7.16A R) to all BNPL firms. The rule requires firms to provide clear, prominent and timely prompts to consumers to remind them that the BNPL offer period is about to end, thus incentivizing them to repay the credit before they incur interest.[289] In response to feedback received, the FCA emphasizes that the prompts need to be provided to consumers in a timely way, be comprehensible to consumers, and sufficiently prominent. The FCA notes its intent to continue monitoring the market and take further action if evidence shows that consumer outcomes are not improving, either via further policy interventions or on a firm-specific basis.[290]
- The adoption of new guidance on communications and financial promotions to all firms that offer BNPL deals.[291] The guidance clarifies that firms should present BNPL offers in a clear and balanced way, highlighting relevant risks in a prominent manner, including the limitations that might apply to promotional or introductory offers and the circumstances and method by which they apply interest. Having reflected on the feedback received, the FCA does not deem it necessary to revise the proposed guidance to make it more detailed or prescriptive.[292] The FCA stresses that the language firms use in their communications needs to be capable of being understood by consumers. Firms need to consider the financial capability of the consumers in their target market as part of their general obligations under Principle 7 of the FCA Principles for Businesses.[293]

In addition to these disclosure remedies, the FCA confirms that BNPL firms must not backdate interest on the principal amount that is repaid within the offer period.[294] Consumers should get full credit for partial repayments they make during the BNPL offer period, rather than being charged interest on these sums if they do not repay the full balance by the end of the offer period.[295] In response to feedback received, the FCA notes that charging interest on BNPL debt involves considerable complexity, as partial repayments are treated differently depending on whether the full balance is ultimately cleared at the end of the offer period. This creates confusion for consumers when they decide their optimal repayment strategy since they may not always know whether they will ultimately incur interest. The new rule on partial repayment aims at addressing this issue by changing the structure of the BNPL products so that there is consistent treatment of sums repaid in the offer period, regardless of whether the balance is

[288] Ibidem.
[289] Id., p. 11.
[290] Ibidem.
[291] Id., p. 12.
[292] Ibidem.
[293] Ibidem.
[294] Id., pp. 12 – 14.
[295] Ibidem.

ultimately cleared. This is intended to create a simpler product that is easier to understand and creates the right incentives for consumers to timely repay their BNPL debt while incurring less interest.[296]

3.2 The CAP's Guidance on Advertising Delayed Payment Services and the ASA's Rulings on BNPL Firms (December 2020 - April 2022)

On December 1, 2020, the CAP published new guidance setting out the restrictions for advertising delayed payment (BNPL) services ("CAP Guidance").[297] The CAP Guidance covers services that are not regulated by the FCA and have the following characteristics: [298]

- Charge no interest (although they may charge late payment fees);
- Allow consumers to defer payment by either charging the full amount after a set period (e.g., 30 days) or by allowing for payment in periodic installments (with or without an upfront payment); and
- Integrate into the checkout process in online shops, which typically form a marketing communication subject to regulation under the CAP Code.[299]

The CAP Guidance sets out advice relating to various forms of marketing communications and the information to be provided during the online checkout process to ensure that communications regarding BNPL services are fair, transparent, and not misleading, and consumers fully understand the service being offered comprises a form of credit.

In accordance with the CAP Guidance: [300]

- Advertisers must make it clear that delayed payments are a form of credit;
- Advertisers should not promote delayed payment services as having no impact or consequences on credit score, unless they can demonstrate otherwise;
- Advertisers should not state or imply that delayed payment services are suitable for all customers or a "risk-free" way of obtaining credit;
- Advertisers should make it clear whether any fees or late charges apply and must exercise caution in the use of the word "free"; and
- Under the CAP Code, ads for financial products are required to state the nature of the contract being offered, any limitation, expense, penalty, or charge, and the terms of the withdrawal, except where ads are very brief or general in scope, in which case this information should be freely available before using the service. Therefore, the CAP would expect all non-broadcast marketing that is brief or general in scope to include a link to comprehensive online information

[296] Id., pp. 14 and 15.
[297] See, Committee of Advertising Practice (CAP), Guidance on advertising delayed payment services, Advertising Guidance (broadcast and non-broadcast), CAP Guidance (December 2020); Committee of Advertising Practice (CAP), New guidance on the advertising of delayed payment services (buy now, pay later services), CAP News (December 1, 2020).
[298] See, Committee of Advertising Practice (CAP), Guidance on advertising delayed payment services, Advertising Guidance (broadcast and non-broadcast), cit., p. 3. Note the list of relevant services may change when the new legislation will come into effect as further discussed below.
[299] See, Committee of Advertising Practice (CAP), The CAP Code - The UK Code of Non-broadcast Advertising and Direct & Promotional Marketing, 12th Edition (September 2020).
[300] See, Committee of Advertising Practice (CAP), Guidance on advertising delayed payment services, Advertising Guidance (broadcast and non-broadcast), cit., pp. 5 and 6.

(including terms and conditions). Ads referring to specific products (including where the service is offered during checkout) must include the above required information in the ad itself.

The second part of the CAP Guidance sets out advice relating to product information during the online checkout process.[301] The CAP raises a concern that delayed payment services may be provided in such a way that consumers may not always realize they are incurring debt and the services being offered comprise a form of credit. To address this issue, the CAP Guidance provides that: [302]

- Where delayed payment services are provided at checkout, their nature should be made clear to customers and (where relevant) it should be explained that standard forms of payment are available, particularly when the delayed payment option is presented in the form of a card detail entry form; and
- Prior to deciding to use a delayed payment service, customers must have access to the full terms and conditions of the service (including any arrangements or consequences for late or missed payments), which should be easy to locate, typically via a link placed in the section of the checkout process that offers the service. Any specific conditions or qualifications, including fees, penalties, and payment schedules should be made clear as part of the checkout process, not just through a link to the terms.

Advertisers had until March 2, 2021, to adjust their commercials to the CAP Guidance.

Shortly following the publication of the CAP Guidance, on December 23, 2020, the ASA ruled that an Instagram influencer campaign commissioned by BNPL firm Klarna in 2020 contravened its guidelines.[303] The ASA investigated a complaint alleging that certain Klarna ads promoted by four Instagram influencers had irresponsibly encouraged the use of Klarna's BNPL services to help people "lift their low mood" during the Covid-19 lockdown. In its defense, Klarna argued that the influencers' posts were not irresponsible, and that the key theme was not about shopping but about improving mental health and personal care during the Covid-19 lockdown period. Similarly, the influencers stated that their posts were about the uplifting effects of the products being promoted, not shopping with Klarna.[304]

Although the ASA acknowledged that purchasing non-essential items may be a source of comfort for some people during the national lockdown, the ASA expressed the view that each ad promoted the use of Klarna's deferred payments services. Having considered the case, the ASA concluded that in the context of the challenging circumstances caused by the Covid-19 induced lockdown (including impacts on people's financial and mental health), the ads had irresponsibly encouraged the use of credit to improve people's mood and had breached CAP Code (Edition 12) rule 1.3 (Social responsibility).[305] The ASA stressed that it's imperative that BNPL providers adequately consider the impact of their advertising on consumers and ensure they don't encourage inappropriate use of credit. For these reasons, the ASA requested Klarna and the influencers to remove or amend the ads and to not post future advertising that

[301] Id., p. 7.
[302] Ibidem.
[303] See, Advertising Standards Authority (ASA), ASA Ruling on Klarna Bank AB, ASA Rulings (December 23, 2020).
[304] Ibidem.
[305] Ibidem.

irresponsibly encourages the use of Klarna's deferred payment service, particularly by linking it with lifting or boosting mood.[306]

Commenting on the ruling, Klarna confirmed that it had removed the posts banned by the ASA and indicated that it had actively and substantially changed its influencer and advertising policy and made a large marketing investment in KlarnaSense, an initiative designed to encourage responsible spending.[307]

Subsequently, in May 2021, the ASA investigated a complaint over a statement published on BNPL firm Laybuy's website that the credit checks performed by Laybuy do not impact the customers' credit scores.[308] The ASA concluded that that statement was misleading and breached CAP Code (Edition 12) rules 3.1 (Misleading advertising) and 3.7 (Substantiation). In its defense, Laybuy indicated that the statement at issue had appeared erroneously on its website and had been removed before it was made aware of the complaint by the ASA. The company further explained that it was working to ensure its future marketing communications would be subject to improved internal processes and controls, and that it was contacting credit report providers to reverse the impact of its credit searches on affected consumers.[309] The ASA acknowledged the actions implemented by Laybuy and requested the company to ensure that its future marketing communications would not claim that the credit checks performed on customers would not affect their credit scores if that were not the case.[310]

More recently, in April 2022, the ASA investigated two complaints by a member of the public and campaign group Go Fund Yourself relating to three adverts for Laybuy on Refinery29.com and Instagram.[311] Two of these ads directed users to a "five-minute financial health check," while the other described Laybuy as "the payment provider championing responsibility in the sector." The complaints challenged whether the ads broke the CAP code by (a) not making it sufficiently clear that the products offered by Laybuy were a form of credit and (b) irresponsibly portraying the service as a solution to financial concerns. Of these two issues, only one was upheld.

Having investigated these complaints, the ASA found that the ads did not make it sufficiently clear to consumers that Laybuy's product was a BNPL service, or that its product was a form of credit. Because of this, the ASA concluded that the ads were misleading and breached CAP Code (Edition 12) rules 3.1 and 3.3 (Misleading advertising), 3.9 (Qualification), 14.1 and 14.2 (Financial products). Therefore, the ASA requested Laybuy to ensure that future ads would make it explicitly clear to consumers that the company offers a BNPL product which is a form of credit. On the other hand, the ASA considered that the ads did not portray Laybuy's service as a solution to financial concerns, and therefore concluded that they were not irresponsible. [312]

[306] Ibidem.
[307] See, Klarna, Klarna comment: ASA rules against four Klarna social media posts, Klarna Blog (December 23, 2020).
[308] See, Advertising Standards Authority (ASA), ASA Ruling on Laybuy Holdings (UK) Ltd, ASA Rulings (May 26, 2021).
[309] Ibidem.
[310] Ibidem.
[311] See, Advertising Standards Authority (ASA), ASA Ruling on Laybuy Holdings (UK) Ltd, ASA Rulings (April 6, 2022).
[312] Ibidem.

3.3 The Woolard Review into Change and Innovation in the UK Unsecured Credit Market (September 2020 – February 2021)

On September 16, 2020, the FCA announced that the FCA Board had asked former FCA Interim Chief Executive, Chris Woolard CBE, to conduct a review into change and innovation in the unsecured consumer credit market, and how regulation can support a healthy unsecured consumer credit market (the "Woolard Review").[313]

On November 2, 2020, the FCA issued a call for input to gather views and feedback from a variety of key stakeholders, including consumer groups, regulated and unregulated providers of credit, and retail businesses (the "FCA Call for Input"). The structure of the FCA Call for Input followed four main themes: drivers and use of credit; change and innovation in the supply of credit; the role of regulation in unsecured credit markets; and the impact of Covid-19 and the FCA's response.[314]

The Woolard Review considered the responses to the FCA Call for Input along with various research and studies, individual interviews, and roundtables that the FCA undertook during the review period. In addition, an advisory panel and staff at the FCA assisted throughout the review process.

On February 2, 2021, the FCA published a report outlining the findings and recommendations of the Woolard Review commissioned by the FCA Board (the "Woolard Review Report").[315] The Woolard Review Report sets out how regulation can better support a healthy market for unsecured lending, considering the impact of the recent Covid-19 pandemic, changing business models and new developments in the unregulated BNPL unsecured lending.

Commenting on the Woolard Review Report publication, former FCA Interim Chief Executive and Chair of the Woolard Review, Christopher Woolard CBE, said: "[m]ost of us will use credit at some point in our lives. So, it's vital that we have a fair market that works for everyone. New ways of borrowing and the impact of the pandemic are changing the market, with billions of pounds now in unregulated transactions and millions of consumers at greater risk of financial difficulty … Changes are urgently needed: to bring BNPL into regulation to protect consumers; to ensure that there is secure provision of debt advice to help all those who may need it; and to maintain a sustained regulatory response to the pandemic … Alongside these urgent issues the [Woolard Review Report] sets out a series of recommendations for how the FCA, working with partners, can build a better market in future."[316]

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[313] See, Financial Conduct Authority (FCA), Christopher Woolard to chair review of unsecured credit market regulation, FCA Press Release (September 16, 2020).

[314] See, Financial Conduct Authority (FCA), Call for Input: Review into change and innovation in the unsecured credit market (The Woolard Review), FCA Call for Input (November 2020).

[315] See, Financial Conduct Authority (FCA), The Woolard Review - A review of change and innovation in the unsecured credit market, Report to the FCA Board (February 2, 2021); Financial Conduct Authority (FCA), FCA publishes review into unsecured credit market, FCA Press Release (February 2, 2021); Financial Conduct Authority (FCA), A review of change and innovation in the Unsecured Credit Market (The Woolard Review), FCA Publications (February 2, 2021). See, also, Bird & Bird, Buy Now Pay Later – how does it work and is it regulated?, Bird & Bird Publications (September 22, 2021); Skadden, Arps, Slate, Meagher & Flom LLP, The UK's Woolard Review Proposes Regulations for BNPL Credit Agreements, Skadden Publications (February 9, 2021); Linklaters LLP, UK joins global trend by putting buynow, pay-later under the regulatory spotlight, Linklaters Insights (February 3, 2021); Clifford Chance LLP, Woolard Review – Conclusions and Impact on Regulation in the UK "Buy-Now-Pay-Later" Industry, Clifford Chance LLP (February 3, 2021); Hogan Lovells, Woolard Review sets out vision for unsecured credit: now over to the FCA to make it happen, Hogan Lovells (February 3, 2021).

[316] See, Financial Conduct Authority (FCA), FCA publishes review into unsecured credit market, cit.

The Woolard Review Report sets out 26 recommendations aimed to make the UK unsecured credit market fit for the future. Among these recommendations is a proposal to regulate BNPL credit agreements that currently fall outside the FCA regulation. These agreements often take the form of either deferred payment or short installment loans and typically rely on the exemption in Article 60F(2) of the RAO previously discussed. The Woolard Review Report notes that this exemption was never intended for BNPL products but only for short-term invoice deferrals. It, therefore, concludes that BNPL products should be brought within the regulatory perimeter as a matter of urgency because they can bring significant benefits, but also pose potential consumer harm if they are not adequately regulated.[317] The recommended regulation would protect people who use BNPL products and make the market sustainable, and regulatory oversight would ensure that the BNPL products develop in a beneficial way to the end consumer. [318]

The Woolard Review Report acknowledges that BNPL products (along with employer salary advance schemes) have the potential to disrupt the existing unsecured credit market by offering low or zero-cost alternatives to mainstream or high-cost credit.[319] The Woolard Review Report further notes that data shared with the FCA by some of the leading BNPL providers show that the value of BNPL transactions in the United Kingdom grew exponentially in 2020, tripling, nearly quadrupling between January and December 2020 up to £2.7 billion in December 2020, and it is expected to continue to grow rapidly in the next few years.[320] A survey of consumers carried out by the FCA in December 2020 found that 11% of consumers (c. 5 million individuals) used BNPL products since the beginning of the Covid-19 pandemic.[321] The number of consumer searches for BNPL increased notably following the first Covid-19 lockdown.[322]

The Woolard Review Report recognizes that the emergence and expansion of unregulated BNPL products give consumers an alternative to more expensive credit and promote easy access to credit.[323] If repaid on time, BNPL debt can be significantly cheaper than most alternative forms of regulated credit. Consumer research conducted as part of the Woolard Review also highlighted how users can significantly benefit from the simplicity of the product.[324]

Although BNPL products can bring significant benefits to consumers, the Woolard Review Report warns that these products also come with significant potential for consumer harm.[325] The Woolard Review Report sets out some specific concerns and identifies several areas of potential consumer detriment that could crystallize if the BNPL market continued to grow unregulated, including the following:

- BNPL consumers may not fully appreciate the credit nature of BNPL offers and may not apply the same level of scrutiny to their decision-making as they would for other credit products,

[317] See, Financial Conduct Authority (FCA), The Woolard Review - A review of change and innovation in the unsecured credit market, cit., p. 43.
[318] Ibidem.
[319] Id., p. 41.
[320] Id., p. 44.
[321] Ibidem.
[322] Ibidem.
[323] Id., p. 46.
[324] Ibidem.
[325] Ibidem.

including consideration of the potential consequences of failing to repay. This risk is amplified as the differences between these BNPL products are often not obvious to consumers when options are initially presented. [326]

- The complex nature of the BNPL products may cause customers to erroneously believe that BNPL products are regulated and come with associated protections, including the ability to refer complaints to the Financial Ombudsman Service (FOS).[327]
- The presentation of BNPL products and the overall consumer journey may be designed to drive sales without considering the affordability of the BNPL commitment the consumer is taking on. The consumer journey design may, in some instances, play into consumers' behavioral biases to promote the use of the product and sales for the retailer, to the detriment of the consumers, who may be incentivized to make impulsive decisions that are not in their best interest.[328]
- BNPL offers are sometimes presented as a default payment method or in a long list of indistinguishable options, which creates confusion for consumers and makes it difficult for them to make an informed choice.[329]
- There is a heightened risk of harm around the use of BNPL products by vulnerable customers, who may be more likely to take out POS credit they cannot afford than other consumers.[330]
- Most BNPL providers complete a basic credit assessment and may not have visibility of missed payments with other providers or the consumers' wider financial circumstances. Their assessment is typically performed through a combination of "soft" credit searches and previous repayment history and tends to focus on credit risk, rather than affordability. This creates the risk that consumers may be granted access to BNPL credit they cannot afford to repay on time. Data provided by UK major banks show that more than one in ten of customers of UK major banks using BNPL were already in arrears in November 2020.[331]
- Since consumers may have multiple outstanding transactions across different providers, there is a risk that the overall amount owed by them may be substantial and may result in a high-level of unsustainable indebtedness.[332]
- BNPL providers take various approaches to late payments, defaults, and collection practices. Some BNPL providers don't charge any late fees, whilst others charge late payment fees capping them at a set percentage of the initial transaction. Some BNPL providers report late payments and defaults to CRAs, others don't. Additionally, some BNPL providers pass debts onto debt collection agencies, whilst others write the debt off. Most BNPL providers do not continue lending to individuals who have missed their required payments. These practices and other relevant terms applied by BNPL providers are often not clear, thus creating the risk of harm to consumers, who may not be able to compare payment options and make an informed decision on which payment method is right for them.[333]

[326] Ibidem.
[327] Id., p. 47.
[328] Ibidem.
[329] Id., p. 48.
[330] Ibidem.
[331] Id., pp. 48 and 49.
[332] Id., p. 49.
[333] Ibidem.

- Most BNPL providers do not report to CRAs. Because of this lack of transparency, regulated credit providers may not have a complete view of consumers' financial position when assessing affordability, thus creating the risk of consumers being approved for credit they can't afford.[334]
- With the expansion of BNPL products beyond online retail platforms, additional risks arise that in-store advertising of BNPL products may not be sufficiently completed or clear to enable consumers to make informed decisions when using these products.

Because of the potential harm to consumers discussed above, the Woolard Review Report recommends that the FCA work with the HM Treasury to ensure the necessary amendments to the legislation are made to bring BNPL products within the scope of regulation as a matter of urgency. Once the required powers are obtained, the FCA should develop a proportionate regulatory framework, including addressing how credit information should work within the BNPL market. The FCA and the HM Treasury should be careful not to subject to the new regulation other non-financial organizations that rely on the current exemption, including healthcare services and sport clubs.[335]

As part of this recommendation, the Woolard Review Report suggests that the FCA and the HM Treasury should also consider the regulatory treatment of partner retailers. The Woolard Review Report notes that, once exempt BNPL agreements are regulated, Article 36A(1)(a) of the RAO will be met and the retailer will need to be authorized for credit broking.[336] Since a few risks set out above relate to the presentation of the BNPL products which are often on a retailer's website, the Woolard Review Report emphasizes that retailers should be subject to appropriate high-level regulation to ensure they treat consumers fairly. Any such regulation applicable to retailers would need to be proportionate and suitable.[337]

Following the Woolard Review Report publication, the FCA expressed its support for the recommendations directed to the FCA. The FCA Board acknowledged the strong and pressing case to bring BNPL into regulation and asked the FCA executive to build the Woolard Review's recommendations into its business planning. [338]

Commenting on the publication of the Woolard Review Report, Charles Randell, Chair at the FCA, said: "Unaffordable credit can damage the lives of people who are already struggling to manage everyday expenses. While we have made progress in reducing unaffordable debt in the years before coronavirus, the pandemic has had an unequal impact on households. Many people have been able to reduce their debts, but some of the poorest in our society have exhausted any savings or run up more debts. All the authorities which cover debt and debt advice must act together systematically to prevent problem debt and to help people get out of a spiral of debt through properly funded debt advice … Regulation should be consistent and the [Woolard Review] shows how we can ensure high standards in consumer credit regardless of the form of credit … As the market innovates and changes, regulators and legislators need to respond quickly and decisively to protect consumers by facilitating credit where it is beneficial and

[334] Id., p. 50.
[335] Id., pp. 43, 52.
[336] Id., p. 52.
[337] Ibidem.
[338] See, Financial Conduct Authority (FCA), FCA publishes review into unsecured credit market, cit.

clamping down on it when it does harm. The FCA agrees that there is a strong and pressing case to bring BNPL business into regulation."[339]

3.4 The HM Treasury's Consultation on the Proposed Regulatory Framework for BNPL (October 2021 – January 2022)

On January 19, 2021, Christopher Woolard CBE, Former FCA Interim Chief Executive and Chair of the Woolard Review, wrote to John Glen MP, Economic Secretary to the HM Treasury, outlining the recommendation that interest-free BNPL products should be brought into FCA regulation.[340] John Glen MP responded on January 28, 2021, explaining that the UK Government is supportive of the recommendation and that legislation would be brought forward as soon as the parliamentary time allows.[341]

In parallel, on January 28, 2021, Charles Randell, Chair at the FCA, wrote to John Glen MP, Economic Secretary to the HM Treasury, setting out the FCA Board's view on the Woolard Review Report and proposing that the FCA works with the UK Government to design the appropriate regulation.[342]

Shortly after that, on February 2, 2021, the UK Government announced its intention to bring unregulated interest-free BNPL products into regulation to address the potential risks of consumer detriment highlighted in the Woolard Review Report, while ensuring people can continue to benefit from these products with the right protections.[343]

A few months later, on October 21, 2021, the HM Treasury published a consultation on a proposed regulatory framework for BNPL products ("HM Treasury BNPL Consultation").[344] The HM Treasury sought views from a wide variety of interested parties, including consumer groups, BNPL lenders, short-term interest-free credit lenders and retailers. The consultation period closed on January 6, 2022.

While the Woolard Review Report concludes that BNPL agreements present a greater risk to consumers than other agreements falling within the exemption set out in Article 60F(2) of the RAO, the HM Treasury expresses the view that BNPL products can enhance consumer choice, flexibility, and competition and that there is yet no sufficient data showing significant widespread consumer detriment caused by such products. Accordingly, the HM Treasury proposes only limited regulation of BNPL at this stage.

The HM Treasury BNPL Consultation sets out policy options to achieve a proportionate and balanced approach to the regulation of BNPL. To that end, it: (i) considers the potential scope of regulation to

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[339] Ibidem.
[340] See, Christopher Woolard CBE, Chair, Review of Change and Innovation in the Unsecured Credit Market, Letter to John Glen MP, Economic Secretary to the Treasury (January 19, 2021).
[341] See, John Glen MP, Economic Secretary to the Treasury, Letter to Christopher Woolard CBE, Chair, Review of Change and Innovation in the Unsecured Credit Market (January 28, 2021).
[342] See, Charles Randell, FCA Chair, Letter to John Glen MP, Economic Secretary to the Treasury (January 28, 2021).
[343] See, HM Treasury, Buy-now-pay-later products to be regulated, HM Treasury Statements (February 2, 2021).
[344] See, HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Consultation (October 2021); HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Statements (October 21, 2021). See, also, Linklaters LLP, UK plans for regulating buy-now, pay-later, Linklaters (November 2021); Skadden, Arps, Slate, Meagher & Flom LLP, UK Treasury Launches Consultation on Regulation of 'Buy Now, Pay Later' Financing, Skadden Publications (October 29, 2021); Hogan Lovells, Buy-Now-Pay-Later regulation: HM Treasury consults on form and scope, Hogan Lovells (October 21, 2021); Hogan Lovells, Buy Now, Regulate Later: is a new regime on the horizon?, Hogan Lovells (October 27, 2021).

target as closely as possible products where consumer detriment could arise; and (ii) seeks views on a range of regulatory controls that could be put in place for BNPL, so that they are adapted to the business model and focused on those elements of lending practice that are most closely linked to the potential consumer detriment in the BNPL market.[345]

In looking to create a proportionate approach to the regulation of BNPL, the HM Treasury outlines four objectives: [346]

- BNPL activities should be subject to an intervention that is proportionate to the level of risk that they present and is not so burdensome that it inhibits the product being offered or reduces consumer choice;
- Consumers should be adequately and fairly protected from detriment, and can access dispute resolution regarding the conduct of lenders;
- Regulation for BNPL should not adversely impact competition and innovation across the wider consumer credit and payments markets; and
- Any burden on merchants offering BNPL as a payment option would be proportionate and manageable and should not disadvantage small and medium enterprises (SMEs) over larger merchants.

In relation to the scope of application of the proposed regulation, the HM Treasury BNPL Consultation suggests that new rules should apply to unregulated BNPL products which currently rely on the exemption from regulation set out in Article 60F(2) of the RAO. These products typically allow consumers to split the cost of a purchase into periodic installments, or to defer the payment for a set period of time after the purchase is made.[347]

The HM Treasury notes that these products follow a common model, whereby a consumer opens an account and enters into an agreement with a BNPL provider, under which the BNPL provider agrees to finance one or more purchases from a wide range of merchants and remit funds to the merchants (net of the applicable merchant fees, which are typically calculated as a percentage of the full value of the credit agreements). Other BNPL models are also emerging, for instance where a third-party lender legally purchases goods from a merchant and then sells them on to the consumer, or where there is no pre-existing relationship between the merchant and the lender. All these BNPL transactions tend to be relatively low value (with the average amount ranging between £65 and £75), are typically online transactions (with BNPL solutions embedded in e-commerce customer journeys), and have usually short repayment terms (either deferring payment for a month or splitting repayments over three to four months).[348]

The HM Treasury observes that developments in consumer behavior in recent years have seen a rapid shift toward online consumption, in which a more comprehensive suite of payment options can be offered more easily to consumers. The trend toward online consumption has accelerated over the last eighteen

[345] See, HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Consultation, cit., pp. 2 and 3.
[346] Id., p. 7.
[347] Id., pp. 5, 9 - 11.
[348] Id., pp. 10 and 11.

months due to the Covid-19 pandemic.[349] In combination, this has resulted in a rapid expansion of BNPL products under the exemption from regulation set out in Article 60F(2) of the RAO, with the potential for significant further growth in the BNPL market in the coming years. [350]

While the HM Treasury recognizes the transformation in the use of this regulatory exemption and agrees with the Woolard Review in relation to the potential risks and sources of consumer detriment posed by unregulated BNPL products, the HM Treasury concludes that there is relatively limited evidence of widespread consumer detriment materializing at this stage. Understanding how any consumer detriment is linked to specific aspects of the BNPL business models is, therefore, critical to ensuring that the scope of regulation is appropriately drawn.[351]

The HM Treasury invited comments on its analysis of the business models that underpin the BNPL market and suggestions on how a clear distinction could be drawn between BNPL and short-term interest-free credit agreements.[352] It also sought evidence of consumer detriment in the BNPL market and views on any specific elements of the BNPL business models which could pose relevant risks.[353]

After investigating the scope of the proposed BNPL regulation through a close examination of BNPL business models, the HM Treasury sought views and comments on key considerations in designing a proportionate system of regulatory controls for BNPL products.

The HM Treasury considers the risks of the BNPL products to be inherently lower than those posed by interest-bearing credit. In light of this, it expresses the view that a number of regulatory controls for the mainstream regulated credit market might be disproportionate for the BNPL market. For these reasons, the HM Treasury focuses on the changes necessary in legislation to ensure a proportionate regulatory approach, noting that the detail of the regulatory regime and the FCA rules that will apply will be developed by the FCA and subject to consultation.[354]

Advertising and Promotions

The HM Treasury BNPL Consultation outlines the existing advertising and marketing requirements applicable to BNPL lenders and merchants,[355] and how these requirements could be strengthened by

[349] Id., pp. 9 and 10.
[350] Ibidem.
[351] Id., p. 11.
[352] Id., pp. 11 – 15. Alongside BNPL products, there are also other types of financial arrangements which fall within the exemption from regulation set out in Article 60F(2) of the RAO, including (i) formal interest-free installment loans, repayable in under a year, usually offered by a third-party and used to finance higher-value goods, and (ii) credit agreements that allow monthly payments for club memberships and season tickets, more often offered without third-party involvement (collectively, "short-term interest free credit agreements"). Whilst it recognizes that there is significant overlap between short-term interest free credit agreements and BNPL, the UK Government notes that there is currently no substantive evidence of widespread consumer detriment or material risks for consumers arising from short-term interest free credit agreements. It therefore proposes to draw the scope of the new regulation so that such credit agreements can continue to operate outside of the regulatory boundary..
[353] Id., p. 11.
[354] Id., p. 16.
[355] Id., pp. 18 and 19 (noting that BNPL agreements are subject to regulations for advertising set out by the UK Advertising Code and monitored by the ASA and the CAP. The ASA can make rulings on specific adverts in case of violation of the Advertising Code. If a firm persistently breaks the Advertising Code, the ASA can refer them to other bodies for further action, such as the Trading Standards and the Office of Communications ("OFCOM"). The ASA often liaise with the FCA in connection with its rulings. The FCA, in conjunction with the Competition and Markets Authority ("CMA"), has also wider powers under the Consumer Protection from Unfair Trading Regulations 2008 ("CPUTR"), which it can enforce in relation to unregulated credit agreements, including BNPL. The rules set out in the CPUTR state that firms must provide consumers with the information necessary to make informed decisions and not omit or hide material information which the average consumer needs). See, also, section 3.2 above.

applying the financial promotions regime to BNPL promotions.[356] The financial promotions regime captures those communications that are "invitations or inducements" to enter into a credit agreement and requires those communicating them – whether they are merchants or credit providers – to be FCA-authorized or to get approval from an FCA-authorized person. The promotion must meet standards set out in the FCA's rules on financial promotions and communications, including that it is "clear, fair, and not misleading."[357]

In practice, this could mean that merchants offering BNPL products would need to obtain approval for promotions of such products from an authorized person (their BNPL lender partner, among others).[358] The HM Treasury notes that the UK Government has separately proposed a broader strengthening of the financial promotions regime requiring that any authorized person wishing to approve promotions go through a gateway process managed by the FCA where they are subject to further checks and training.[359] The HM Treasury envisages that, in combination, this would ensure effective oversight (by improving due diligence and making sure approving firms have relevant expertise) and would provide substantial mitigation from any consumer detriment that could arise from merchants not being subject to credit broking regulation.[360]

Moreover, by bringing BNPL products into regulation, the FCA could supervise BNPL lenders' pre-contractual screens to ensure that relevant information is communicated with sufficient prominence and clarity. If BNPL agreements are regulated, but merchants do not present adequate information about the product or present misleading information, then the lender screens would mitigate these risks by enabling the consumer to make a properly informed decision.[361]

Pre-Contractual Information

Pre-contractual information provided to consumers is a key theme of the HM Treasury Consultation on BNPL. BNPL lenders provide pre-contractual information in a form that they choose, rather than in a form prescribed by regulation. This creates the risk that firms may not give sufficient prominence to important information about the agreement or fail to provide it.[362]

Section 55 of the CCA specifies the form and content of pre-contractual information that must be provided for regulated credit agreements, including the Standard Consumer Credit Information form. In addition to these statutory requirements, firms must comply with FCA rules on pre-contractual disclosure and adequate explanations.[363]

The HM Treasury recognizes that applying the full CCA pre-contract regime would be disproportionate considering the risks and structure of BNPL products. Instead, the HM Treasury suggests that proportionate regulation of BNPL could rely solely on FCA rules on adequate pre-contractual

[356] See, HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Consultation, cit., p. 19.
[357] See, the FCA Consumer Credit sourcebook (CONC) 3.3.
[358] See, HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Consultation, cit., p. 19.
[359] See, HM Treasury, Regulatory Framework for Approval of Financial Promotions: Consultation Response, HM Treasury (June 2021).
[360] See, HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Consultation, cit., p. 19.
[361] Id., pp. 19-20.
[362] Id., p. 20.
[363] See, the FCA Consumer Credit sourcebook (CONC) 4.2.

explanations, while the detailed and inflexible requirements for information disclosure in Section 55 of the CCA could be disapplied.[364] The HM Treasury recognizes that the FCA could make amendments, following consultation and a cost-benefit analysis, to tailor its rules to the specific nature of BNPL agreements if they are brought into regulation.[365]

Form and Content of the Credit Agreement

Similarly, HM Treasury considers it disproportionate to apply the CCA agreements requirements to all BNPL products. Instead, it suggests that bespoke legislation on the form and content requirements for BNPL should be developed, which better suits the features of BNPL products and the way consumers use these products in practice.[366]

Improper Execution

Under Section 61 of the CCA, a regulated credit agreement is not executed correctly unless a document in the prescribed form and containing the prescribed content is signed in the prescribed manner. Section 65 of the CCA provides that an agreement not properly executed is unenforceable by the lender unless the lender obtains a court order. These provisions create strong incentives for lenders to provide the necessary information to a consumer or risk the agreement becoming unenforceable.[367]

The HM Treasury believes these CCA provisions on improper execution to be a valuable element of a future BNPL regulatory framework and suggests that they should apply to BNPL agreements. The HM Treasury recognizes that applying these requirements would likely create more friction in the transaction, particularly for digital BNPL, as consumers would need to consider an agreement and take steps to provide a signature. However, it argues that this friction in the customer journey could be useful, allowing customers to more fully consider whether the credit agreement they are entering into meets their needs.[368]

Creditworthiness Assessment

As BNPL products are not currently regulated by the FCA, BNPL providers have no obligation to conduct creditworthiness assessments (compromising credit risk and affordability) as part of either the onboarding of new customers or when entering into individual agreements.[369]

The HM Treasury recognizes this is a key concern raised in the Woolard Review Report. It emphasizes that creditworthiness assessments help ensure that consumers don't take on debts they cannot reasonably repay and are a key feature of responsible lending practices.[370] For these reasons, the HM Treasury suggests that proportionate regulation of BNPL should apply the FCA rules on creditworthiness to BNPL agreements, thus requiring credit checks for new BNPL customers, when adding new BNPL agreements or increasing credit limits.[371]

[364] See, HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Consultation, cit., p. 20.
[365] Id., p. 21.
[366] Ibidem.
[367] Id., p. 22.
[368] Ibidem.
[369] Ibidem.
[370] Ibidem.
[371] See, the FCA Consumer Credit sourcebook (CONC) 5.2A.

Furthermore, the HM Treasury recognizes that concerns have been raised about inconsistencies in BNPL providers' use of credit reference agencies and how BNPL agreements are reported on consumers' credit files. It emphasizes that clear and consistent credit reporting will be an important part of the responsible provision of BNPL products. For these reasons, the HM Treasury intends to work with credit reference agencies and the wider industry to ensure BNPL is reflected on consumers' credit files and that a consistent approach to reporting is adopted and followed across the industry.[372]

Arrears, Default, and Forbearance

Unlike regulated agreements, BNPL providers are currently not subject to specific requirements around how they should treat customers in financial difficulty, not how they should communicate with borrowers that have missed payments.[373] As identified by the Woolard Review, this has resulted in an inconsistent approach by BNPL providers and significant uncertainty for consumers on whether BNPL providers charge late payment fees or whether debts could be passed on to the debt collection agencies.

In light of this, the HM Treasury expresses the view that proportionate regulation of BNPL should include some requirements around how firms treat customers in financial difficulty.[374]

CCA Requirement on Firms for Consumers in Financial Difficulty

The CCA contains requirements for firms in relation to the provision of post-contractual information on arrears and defaults, and the provision of information before a lender can take certain action to enforce a term of a regulated credit agreement. The HM Treasury notes that these requirements aim to encourage customers in financial distress to act early to resolve payment difficulties.[375] The form and content of these notices are prescribed in secondary legislation, ensuring consistency across firms. At this stage, the HM Treasury's view is that applying these requirements to BNPL could help address the lack of consistent treatment of customers in financial difficulty identified by the Woolard Review as a key source of potential consumer detriment. The HM Treasury invites views on the proportionality of such controls.[376]

Section 75

Section 75 of the CCA makes a creditor jointly and severally liable in certain circumstances for a supplier's breach of contract or misrepresentation of goods or services. For this provision to apply, the item or service purchased using the credit must be between £100 and £30,000.

Although some BNPL providers provide their own buyer protection schemes, this is largely inconsistent across the industry. Because of this, the HM Treasury suggests that statutory protection should apply as part of the new regulation of BNPL so that it is in line with other regulated credit agreements.[377]

Small Agreements

[372] See, HM Treasury, Regulation of Buy-Now Pay-Later: Consultation, HM Treasury Consultation, cit., p. 23.
[373] Ibidem.
[374] Ibidem.
[375] Id., pp. 25 and 26.
[376] Ibidem.
[377] Id., p. 26.

Some parts of the CCA do not apply to "small agreements," which are defined under Section 17 of the CCA as regulated consumer credit agreements for credit not exceeding £50 (other than a hire-purchase or conditional sale agreement). Acknowledging that many BNPL contracts will be below £50 and would therefore be classified as a "small agreement," the HM Treasury suggests that under the new regulation of BNPL the scope of Section 17 of the CCA be narrowed so that BNPL transactions below £50 would not be exempt.[378]

Financial Ombudsman Service ("FOS") and Redress

Some BNPL firms provide a complaints process separate from their regular customer services team to which customers can escalate complaints. However, this is often not truly independent, and can differ significantly across the industry. Because of this, the HM Treasury recommends that proportionate regulation of BNPL should include the ability for consumers to access the FOS for issues concerning the conduct of BNPL lenders.[379] This is expected to ensure greater consumer protection in the BNPL market and access to appropriate dispute resolution mechanisms.[380]

Credit Broking

Under the existing regulatory framework, where a business introduces a customer to a lender with a view to the customers entering into a regulated credit agreement, the business will be undertaking the regulated activity of "credit broking," and as such it will need to be authorized and regulated by the FCA and comply with relevant FCA rules and CCA provisions.[381]

Merchants that offer BNPL and short-term interest-free agreements as a payment option are not currently "credit broking" because broking such credit agreements is not within the existing regulatory perimeter. However, if the exemption from regulation set out in Article 60F(2) of the RAO were to be amended so that some or all of these credit agreements become regulated, then merchants' broking of such credit agreements would constitute the regulated activity of "credit broking." This, in turn, would create relevant burdens for merchants, including: applying for authorization; ongoing monitoring of compliance with FCA rules; regularly submitting data to the FCA on financial information and transaction volumes; informing the FCA about changes to the business; and paying the FCA's periodic fees and levies.[382]

Given the significant costs of compliance with such requirements, there is a risk that many merchants would instead cease to offer BNPL as a payment option. This, in turn, could limit consumer choice and may confer an unfair competitive advantage to larger merchants, many of whom are already FCA authorized for credit broking or have the capacity and means to become so.[383] For these reasons, the HM Treasury suggests that any regulation of BNPL should be accompanied by an exemption so that merchants would be exempt from credit broking permission where they offer regulated BNPL credit (possibly subject to limited exceptions for higher-risk circumstances, including for domestic premises

[378] Id., pp. 26 and 27.
[379] Id., p. 27.
[380] Ibidem.
[381] Id., p. 16.
[382] Id., pp. 16 and 17.
[383] Id., p. 17.

suppliers).[384] The HM Treasury considers that any potential risks to consumer detriment arising from merchants as credit brokers could be adequately mitigated by existing protections as well as other interventions, including relevant amendments to the financial promotions regime, the application of specific CCA provisions, and the CPUTR, which protects consumers from unfair or misleading trading practices.[385]

As previously indicated, the HM Treasury Consultation on BNPL closed on January 6, 2022. The HM Treasury is expected to provide a summary of the responses and set out the next steps for its work on the proposed regulation of BNPL in the second half of 2022. In parallel, the FCA is developing its approach to the authorization gateway and supervision and plans to open a consultation on BNPL in 2022, which could push regulation to late 2022 or 2023.

3.5 Contract Changes Driven by the FCA and the FCA's Guidance for BNPL Firms (February 2022)

On July 15, 2021, Nikhil Rathi, FCA Chief Executive Officer, presented the FCA's Business Plan for the coming year.[386] In his speech, he discussed the FCA's role in a post-Covid-19 economy, and emphasized the intent of the FCA to keep pace with technological changes that are shifting the relationship between consumers and firms, as well as to adjust to economic challenges and a growing remit.[387] He further noted the commitment of the FCA to continue being a forward-looking, proactive regulator and to make progress on three main fronts: being more innovative, testing the limits of its powers and better engaging with partners, and being more adaptive. All the above while promoting a regime of accountability and a culture of transparency.[388] Significantly, he highlighted the need for the FCA to take a holistic approach and to act assertively on harm around the edges of the FCA's regulatory perimeter to ensure consumer protection and market integrity.

FCA Chief Executive Officer, Nikhil Rathi's words were echoed by Nisha Arora, FCA Director of Consumer and Retail Policy, in her remarks at the Westminster Business Forum on October 8, 2021. In her speech, she emphasized the need for the FCA to revisit the boundaries of what is and isn't regulated credit as new credit products develop and consumers' use of them changes.[389] She further acknowledged that BNPL is a product that can have significant benefits for consumers as it develops and becomes more widespread, but it also carries risks and the potential for consumer harm.[390] She then went on to confirm the intent of the FCA to consult on rules for the BNPL sector and set clear standards for BNPL firms after the UK Government has decided which firms and activities will be regulated.[391] Importantly, she made it clear that, even though the FCA does not yet regulate BNPL firms under consumer credit regulation, all firms must comply with consumer protection legislation, which the FCA has powers to

[384] Id., p. 18.
[385] Id., pp. 17 and 18.
[386] See, Nikhil Rathi, FCA Chief Executive Officer, Transforming to a forward-looking, proactive regulator, Speech delivered at the FCA's Our Role and Business Plan webinar (July 15, 2021).
[387] Ibidem.
[388] Ibidem.
[389] See, Nisha Arora, Director of Consumer and Retail Policy, Regulating for better outcomes - next steps in consumer credit, Speech given at Westminster Business Forum (November 8, 2021).
[390] Ibidem.
[391] Ibidem.

enforce.[392] The FCA will keep using its existing consumer protection powers to protect BNPL users where the FCA sees poor practice, for example, by scrutinizing marketing materials and how these products are promoted.[393]

On the backdrop of these remarks, the FCA has continued enforcing the Consumer Rights Act 2015 to assess the fairness and transparency of BNPL terms. More recently, on February 14, 2022, the FCA announced that it had secured changes to potentially unfair and unclear terms in the contracts of four major BNPL providers - Clearpay, Klarna, Laybuy and Openpay.[394]

Sheldon Mills, Executive Director of Consumers and Competition at the FCA commented on the FCA's activities: "BNPL has grown exponentially. We do not yet have powers to regulate these firms, but we do have powers to review the terms and conditions of consumer contracts for fairness, and have acted proactively to ensure that the BNPL industry adopts high standards in their terms and conditions … The four BNPL firms we have worked with have all voluntarily agreed to change their approach. We welcome this and hope that the rest of the industry will now follow."[395]

When reviewing the terms and conditions of the aforesaid four BNPL firms, the FCA identified a potential risk of harm to consumers due to the way the following provisions were drafted:[396]

- Terms setting out what happens if a consumer cancels the contract for purchases funded by a BNPL loan - the terms, as initially drafted, required consumers who returned goods to continue paying installments until the BNPL firm received the refund from the retailer and/or confirmation from the retailer that the goods had been received. These terms raised the concern that the loan agreement may not have been terminated in accordance with applicable regulation where consumers exercised their right to cancel the online sales contract by returning all the goods forming the order, thus requiring customers to continue paying installments or additional fees and charges after the loan agreement should have been terminated.
- Terms enabling the firms to terminate and/or suspend a consumer's account or access to services – the terms, as originally drafted, were giving BNPL providers excessive discretion and could be used to terminate and/or suspend a consumer's account for any reason without notice and restrict or end the consumer's access to their account unreasonably.
- Right of set-off terms - the terms, as originally drafted, could be used to inappropriately exclude the right of consumers to set off the amount owed to them by a BNPL firm from payments due to that firm.

[392] Ibidem.
[393] Ibidem. The FCA has consumer protection powers outside of the Financial Services and Markets Act 2000 regime which can apply to both authorized and unauthorized firms where poor practice is found. This includes the Consumer Rights Act 2015 ("CRA") for contracts entered into from October 1, 2015, and the Unfair Terms in Consumer Contracts Regulations 1999 for contracts entered into between July 1, 1995, and September 30, 2015.
[394] See, Financial Conduct Authority (FCA), FCA secures contract changes for buy-now-pay-later customers, FCA Press Release (February 14, 2022). See, also, Siddharth Venkataramakrishnan, FCA makes 'buy now, pay later' schemes redraft terms, Financial Times (February 14, 2022); Huw Jones, Britain cracks down on 'buy now pay later' firms, Reuters (February 14, 2022); Oliver Smith, FCA starts to push for buy now, pay later improvements, Altfi (February 15, 2022).
[395] Ibidem.
[396] See, Financial Conduct Authority (FCA), FCA drives changes to Buy Now, Pay Later (BNPL) firms' contract terms, FCA Statements (February 14, 2022).

- Continuous payment authority terms – some of the firms' terms did not make it clear how a consumer could cancel their continuous payment authority.

The four BNPL firms involved in the review fully cooperated with the FCA and took prompt action to address the identified concerns. They agreed to amend their terms on issues like contract cancellations and continuous payment authorities to make them fairer and easier to understand. This includes changing their cancellation terms to better reflect how they are applied in practice and to better incorporate applicable consumer contracts regulation, as well as making a facility that allows consumers to pause or suspend payments in these circumstances a contractual right (if not included already).[397] Three of the four BNPL firms (Clearpay, Laybuy, and Openpay) also agreed to voluntarily refund customers who had been charged late payment fees in specific circumstances.[398]

In addition to summarizing the changes made by four BNPL firms to their contract terms, the FCA has provided guidance for firms in the BNPL sector more generally to ensure that their terms and conditions comply with relevant requirements of consumer protection legislation.[399] In accordance with FCA's guidance, BNPL firms should:

- ensure that their contract terms: (i) comply with the fairness and transparency requirements of the Consumer Rights Act 2015 and corresponding requirements under the Unfair Terms in Consumer Contracts Regulations 1999 for contracts entered into between July 1, 1995, and September 30, 2015; and (ii) consider regulation 38(1) of the Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013 ("CCRs");
- review the circumstances in which they have previously charged late payment fees to consumers for not paying installments (as applicable) and provide redress where these late payment fees have been charged inappropriately; and
- respond swiftly to any consumer who contacts them about late fees incurred in circumstances similar to those specified.

Lastly, BNPL firms should carefully consider the following matters when reviewing their existing contract terms and drafting new ones:[400]

- Terms setting out what happens if a consumer cancels the contract for purchases funded by the BNPL loan - all firms should (i) take into account the CCRs, with particular focus on the cancellation provisions, (ii) clearly set out the timing and how they will process the refunds (fully and partially) when the consumer cancels and/or returns goods to the retailer, and (iii) consider including any facility they provide to consumers to pause or suspend payments, in situations where the consumer cancels or returns goods, as a contractual right.
- Terms enabling firms to terminate and/or suspend a consumer's account or access to services - all firms should (i) make it clear when they will provide advance notice to consumers if they intend to terminate and/or suspend a consumer's account or access to services, (ii) explain the

[397] Ibidem.
[398] Note Klarna does not charge late payment fees, and so no such refunds are due to consumers.
[399] Ibidem.
[400] Ibidem.

very limited circumstances when they might terminate and/or suspend a consumer's account or access to services without giving advance notice, ensuring these circumstances are fair and reasonable (e.g., due to suspicious activity), and (iii) make it clear to consumers what the consequences are if they terminate/suspend their account and ensure those consequences are reasonable.

- Right of set-off terms - firms should not prevent the consumer, who has such a right, from being able to offset/deduct money owed to them by the firm from installments.
- Continuous payment authority terms - firms should clarify how a consumer can cancel their continuous payment authority and its impact on any outstanding payments due.

CHAPTER 4

THE DEVELOPING REGULATORY FRAMEWORK OF BNPL IN EUROPE

The recent consumer uptake of BNPL has caught the attention of EU regulators. As BNPL products have become more widely used across Europe, EU regulators have been tightening their rules on consumer credit to provide greater protection for consumers. The EU Commission presented a proposal for a new directive to regulate consumer credit in June 2021 ("CCD II"), which would bring BNPL products under the scope of the regulation. The proposed CCD II would revise and replace the existing EU Directive on credit agreements for consumers (2008/48/EC) ("CCD").

The comprehensive review of the CCD has been mainly driven by the evaluation of the current consumer credit rules and new developments brought by increased digitalization of financial services, market changes, and the recent Covid-19 pandemic, which have profoundly transformed the decision-making process and habits of consumers in Europe. The proposed CCD II is now under discussion and review by the EU Parliament and the Council of the EU and is expected to enter into force by 2024. The following sections analyze its preparatory steps and contents in more detail.

4.1 The Directive on Credit Agreements for Consumers (2008/48/EC) ("CCD") (June 2008)

Consumer credit is regulated both at the national and EU levels. The CCD entered into force in June 2008, and EU Member States had until June 2010 to transpose it. The CCD established a harmonized EU framework for consumer credit with two main objectives: (i) strengthening consumer protection and thus boosting consumer confidence, and (ii) facilitating the emergence of a well-functioning internal market in consumer credit.

The CCD covers consumer credit between Euro 200 and Euro 75,000 (and above this threshold when the credit is for the renovation of residential property). By contrast, interest-free credits, overdraft facilities to be repaid within a month, and hiring or leasing agreements without an obligation to purchase are among the forms of credit excluded from the scope of application of the CCD. The CCD sets rules on standard information to be included in advertising. It also provides that creditors (or credit intermediaries) must provide consumers with the necessary information to compare different offers and make an informed decision before they are bound by any credit agreement or offer. In addition, consumers have fourteen calendar days to withdraw from a credit agreement without giving any reason, and they can fully or partially discharge their obligations under a credit agreement at any time, giving them the right to a reduction in the total cost of the credit.

The CCD was reviewed several times over the past decade,[401] yet the combination of growing digitalization, insufficient harmonization and issues affecting consumer protection, among other things, have prompted the EU Commission to publish the proposed CCD II aimed at repealing and replacing the existing CCD.

[401] The CCD has been amended by Directive 2011/90/EU, Directive 2014/17/EU, Regulation (EU) 2016/1011 and Regulation (EU) 2019/1243).

4.2 The EU Commission's Reports on the Implementation of the CCD (May 2014 and November 2020)

In May 2014, the EU Commission presented a report on the implementation of the CCD and highlighted a need to continue monitoring its enforcement.[402]

A REFIT evaluation[403] of the CCD was launched in 2018, with results published in 2020 (the "2018-2019 REFIT Evaluation"). The 2018-2019 REFIT Evaluation found that the CCD's objectives are still relevant in a regulatory landscape and have only been partially met. The CCD's practical application and enforcement are significantly fragmented across Europe. Such fragmentation, coupled with legal uncertainty arising from the imprecise wording of some CCD provisions, hampers the functioning of the internal market for consumer credit and does not guarantee a consistent and high level of consumer protection.[404]

In November 2020, the EU Commission produced a further report on the implementation of the CCD, discussing the key results of the 2018-2019 REFIT Evaluation and the lessons learned from the application of the CCD since its adoption.[405]

Since the adoption of the CCD in 2008, digitalization has profoundly and rapidly changed the credit market, including in relation to disclosures, creditworthiness assessments, and decision-making processes. Consumer behavior and preferences have evolved, with consumers increasingly seeking a faster and simpler process for obtaining credit and often accessing credit online. The Covid-19 crisis and the resulting restrictive measures have significantly impacted the EU credit market and consumers by accelerating the digital transformation and making EU consumers more financially vulnerable to a certain extent. Amid the Covid-19 crisis, EU Member States have adopted various relief measures that have sought to alleviate the financial burden of citizens and households.

Against this background, the EU Commission announced a review of the CCD in its Work Programme for 2020. In the revised Work Programme adopted during the Covid-19 pandemic, the adoption date of the review was postponed to the second quarter of 2021.[406]

4.3 Stakeholder Consultations on the CCD (January 2019 and June 2020)

In recent years, the EU Commission has sought feedback and comments on rules applicable to consumer credit at EU level. Two public consultations have been carried out along other forms of consultation.[407]

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[402] See, EU Commission, Report from the Commission to the European Parliament and the Council on the implementation of Directive 2008/48/EC on credit agreements for consumers, COM (2014) 259 Final (May 14, 2014).

[403] The Regulatory Fitness and Performance Programme ("REFIT") is the EU Commission's program for ensuring that EU legislation remains fit for purpose and delivers the results intended by EU lawmakers.

[404] The results of the REFIT Evaluation were published in November 2020. See, EU Commission, Commission Staff Working Document Evaluation of Directive 2008/48/EC on credit agreement for consumers, SWD (2020) 254 final (November 5, 2020).

[405] See, EU Commission, Report from the Commission to the European Parliament and the Council on the implementation of Directive 2008/48/EC on credit agreements for consumers, COM (2020) 963 final (November 5, 2020).

[406] See, EU Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Adjusted Commission Work Programme 2020, A Union that strives for more, COM (2020) 440 final (May 27, 2020).

[407] Additional forms of consultations included stakeholder interviews and surveys, consumer surveys, targeted questionnaires sent to national authorities, workshops, bilateral meetings, EU Member State dedicated expert group meetings, consultation of the Financial Services User Group, and ad hoc discussions during the annual EU Consumer Summits.

In January 2019, the EU Commission launched the first consultation to gather feedback from the public on the functioning of the CCD (the "2019 Consultation").[408] The 2019 Consultation ran between January 14 and April 8, 2019. The questions set out in the 2019 Consultation are tailored to two main categories of stakeholders: Part I focuses on the personal experience of consumers trying to obtain a loan and/or their experience having been granted one; and Part II focuses on stakeholders involved in the implementation of the CCD and/or with detailed knowledge of the functioning of the different elements of the CCD and their impact on the consumer credit market.[409]

In relation to Part I:

- Most respondents confirmed to have utilized credit cards, personal credit and/or authorized overdrafts.[410]
- Almost all respondents obtained credit in the EU Member State of residence and did not seek credit in a different EU Member State.[411]
- Most respondents confirmed to have come across advertising for credit online, followed by print media and television. The majority of the respondents felt that the advertisements did not contain sufficient information.[412]
- Around a third of the respondents were only presented with one type of credit, while the remaining received explanations about the kind of credit best suited to their situation.[413] Notably, only half of the respondents were aware of the lender's obligation to provide them with the Standard European Consumer Credit Information (SECCI) form before signing.[414]
- A large majority of respondents were familiar with the annual percentage rate of change ("APR"), representing the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit.[415]
- Most respondents confirmed that they undertook a creditworthiness assessment and provided information relating to their income, professional status, household composition, and other outstanding credits.[416]
- Approximately one-fourth of the respondents confirmed to have repaid their debt early. A large majority of the respondents did not attempt to withdraw from the contract within the fourteen-day withdrawal period, nor they seek to re-arrange the schedule or amounts of the repayments or change the type of interest rate.[417]
- Respondents were overall very positive about the application of the CCD, with most of them finding the provisions of the CCD to be beneficial or even very beneficial.[418]

[408] See, EU Commission, Evaluation of the Consumer Credit Directive, EU Commission Public Consultation (January 14, 2019 – April 8, 2019); EU Commission, Evaluation of the Consumer Credit Directive (Directive 2008/48/EC) - Summary report - public consultation, EU Commission (May 2019).
[409] See, EU Commission, Evaluation of the Consumer Credit Directive (Directive 2008/48/EC) - Summary report, cit., p. 1.
[410] Id., p. 2.
[411] Ibidem.
[412] Ibidem.
[413] Id., p. 3.
[414] Ibidem.
[415] Ibidem.
[416] Ibidem.
[417] Id., p. 4.
[418] Ibidem.

In relation to Part II:

- A large majority of the respondents expressed a positive view on the CCD, particularly with regard to the obligation to perform creditworthiness assessments, the rights of early repayment and withdrawal, and the APR.[419]
- A majority of respondents considered the CCD effective in relation to its main features, except for the information provided to consumers in advertising.[420]
- Respondents identified two main benefits of the CCD - the higher standard of consumer protection and the standardization and harmonization across the EU Member States of provisions such as withdrawal rights and early repayment.[421]
- Most of the respondents considered the CCD coherent with the main relevant pieces of EU legislation.[422]
- The majority of the respondents believed the increase in the level of consumer protection to be the primary added value of the CCD. Nearly all respondents expressed the view that most of the key topics covered by the CCD should remain regulated at the EU level.[423]
- When asked to mention any other issues that might require action at the EU level, respondents pointed to a variety of issues, including:[424] (i) removing gold-plating practices and different rules across EU Member States which prevent a level playing field for creditors, lead to increased compliance costs and hinder access to cross-border credit by some stakeholders; (ii) broadening the scope of application of the CCD to cover loans of less than Euro 200 and credit providers and intermediaries currently providing similar services (e.g., peer-to-peer lending, overdraft facilities, etc.); (iii) strengthening enforcement of the CCD to address non-compliance; and (iv) improving rules and adapting them to developments in the consumer credit market driven by increased digitalization, with focus on information disclosure requirements.

In June 2020, the EU Commission launched a second consultation to gather views from the public on four initiatives in the EU consumer policy that the EU Commission was planning to propose in 2020 and 2021 (the "2020 Consultation"): [425] (a) a EU Commission Communication on a new European Consumer Agenda; and (b) three legislative proposals respectively on (i) empowering consumers in the green transition, (ii) a review of the CCD, and (iii) a review of the General Product Safety Directive (2001/95/EC). The EU Commission sought feedback from various stakeholders, including consumers and relevant organizations and institutions. The 2020 Consultation ran between June 30, 2020, and October 6, 2020.

Part (b)(ii) of the public questionnaire includes six questions focused on a review of the CCD, highlighting several challenges hindering its functioning, including the terms of scope, information

[419] Ibidem.
[420] Id., p. 5.
[421] Ibidem.
[422] Ibidem.
[423] Ibidem.
[424] Id., p. 6.
[425] See, EU Commission, Consumer policy – the EU's new 'consumer agenda', EU Commission Public Consultation (June 30, 2020 - October 6, 2020); EU Commission, A New Consumer Agenda Factual summary report – public consultation, EU Commission (October 2020).

provisions and creditworthiness assessment. The public responses provided valuable insights and showed general support for the EU Commission's main priorities:

- A large majority of respondents were generally in favor of an extension of the scope of application of the CCD, with 28% of the respondents supporting an extension to loans obtained by individuals from other individuals, 26% to credits below Euro 200, 21% to loans above Euro 75,000, and 21% to all exempted credit. Significantly only 14% of the respondents did not support any extension of the scope.[426]
- In relation to the contents and timing of pre-contractual information disclosures, 49% of the respondents thought that it would be most beneficial to obtain simplified pre-contractual information focusing only on key features of the offer, and 46% believed the best option would be to use a standardized format (e.g., SECCI).[427] 34% of respondents expressed the view that consumers should receive information at least five days before signing the contract, 24% at least one day before, and another 24% together with the other terms and conditions right before signing.[428]
- The majority of respondents believed that the information disclosed should be accompanied by warning messages (55% (print media), 59% (online), 54% (radio), and 57% (television)), and as a second most preferred option, be given particular prominence, e.g., engaging, salient and upfront display (52% (print media), and 53% (online)) or be reduced to focus on key points (53% (radio), and 49% (television)).[429]
- Respondents expressed different views on potential areas for improvement of the existing rules on responsible lending/borrowing – more than 20% suggested introducing interest rate caps, preventing one-click credit, linking product design and targeted consumers' interest, and prohibiting unsolicited credit offers. Significantly, only 15% of the respondents argued that further measures or improvements would not be required.[430]
- The majority of respondents expressed that EU law should provide common standards on data/methodology for creditworthiness assessments (44%) or the categories of data collected by credit databases (36%). Only 22% of the respondents were of the view that rules on creditworthiness assessment and credit databases should not be changed.[431]
- In relation to the proposed safeguards for consumers and credit providers in the case of macro-economic disruption, 36% of the respondents suggested the adoption by EU Member States of measures encouraging creditors to exercise reasonable forbearance when a borrower is experiencing or is likely to experience financial difficulty, and 34% the provision of specific rules allowing the EU Member States to enact payment moratoria measures while establishing a minimum level of consumer protection for those cases.[432]

[426] See, EU Commission, A New Consumer Agenda Factual summary report, cit., p. 27.
[427] Id., pp. 27 and 28.
[428] Id., p. 28.
[429] Id., pp. 28 - 30.
[430] Id., pp. 30 and 31.
[431] Id., pp. 31 and 32.
[432] Id., pp. 32 and 33.

In addition to the two public consultations discussed above, the review of the CCD has also been closely followed by the EU Parliament, which emphasized the importance of correctly transposing and enforcing the directive in a resolution on the implementation of the CCD in 2012.[433] Subsequently, the EU Parliament highlighted the importance of addressing consumer over-indebtedness and evolving the existing EU legal framework to the digital world to counteract consumer protection risks in a resolution relating to the action plan on retail financial services in 2017.[434] More recently, the EU Parliament organized a hearing on consumer protection in the context of digitalization during the Covid-19 pandemic in March 2021.[435]

Separately, the EU Economic and Social Committee published an Information Report on the evaluation of the CCD in 2019.[436] In addition, a group of authorities from thirteen EU Member States and two EEA countries completed a coordinated compliance check of online advertising and offers to purchase consumer credit products between February and March 2021.[437]

The comprehensive consultation and review process discussed above has helped identify stakeholders' views on key issues relating to the CCD. The digitalization of the credit market has emerged as the main driver to be considered in the review process. Consumer organizations have advocated for an extensive revision of the CCD to address several problems due to the perceived inadequate scope of application of the CCD (which was perceived as being too restrictive), irresponsible lending practices, information overload, data use, and over-indebtedness exacerbated by the recent Covid-19 pandemic. Respondents across all stakeholder groups and EU Member States have argued that the information consumers get at the advertisement and pre-contractual stages needs to be streamlined and to account for the growing use of digital devices to ensure adequate consumer protection. Business representatives have advocated for increased regulatory stability and non-regulatory interventions or targeted changes to the CCD to adapt it to digitalization developments and have proposed simplifying information disclosure requirements, while keeping enough flexibility in the creditworthiness assessment process. National authorities have generally supported a legislative amendment and have recognized that harmonizing rules would support the development of the cross-border market. All stakeholders have appreciated the benefits of debt advisory services for vulnerable consumers and creditors since these services enable creditors to recover debts effectively. The input and comments received from various stakeholders have been processed and utilized to assess the impact of new rules as further discussed below.

4.4 Additional Studies and Reports relating to the CCD (2018 – 2021)

The EU Commission has considered a series of studies and reports on issues relating to responsible lending and borrowing, including the ICF study supporting the CCD's impact assessment (2021),[438] the ICF study supporting the evaluation of the CCD (2020),[439] a behavioral study conducted by LE Europe

[433] See, EU Parliament, Implementation of the Consumer Credit Directive 2008/48/EC, 2012/2037 (INI).
[434] See, EU Parliament, Action plan on retail financial services, 2017/2066 (INI).
[435] See, EU Parliament, Consumer protection in the context of digitalisation during the COVID-19 pandemic, EU Parliament Public Hearing (March 18, 2021).
[436] See, EU Economic and Social Committee, Consumer Credit Directive (evaluation), Information Report, EU Economic and Social Committee Report (July 8, 2019).
[437] See, EU Commission, 2021 – mini-sweep on consumer credit, EU Commission (2021).
[438] See, ICF Consulting Services, Study on possible impacts of a revision of the CCD, ICF Final Report (May 2021).
[439] See, ICF, Evaluation of Directive 2008/48/EC on credit agreements for consumers, ICF Final Report (February 2020).

et al. on the digitalization of the marketing and distance selling of retail financial services (2019),[440] and two CIVIC studies (the first on the over-indebtedness of European households (2013)[441] and the second on measuring consumer detriment in the European Union (2017)[442]).

In addition, the EU Commission completed a mapping exercise relating to the national approaches to creditworthiness assessment pursuant to the CCD in the context of the 2017 Consumer Financial Services Action Plan in cooperation with Member State authorities,[443] which was published in 2018.[444]

4.5 The Impact Assessment for the Proposed CCD II (July 2021)

The EU Commission performed an impact assessment for the proposed CCD II, which was published on July 1, 2021.[445]

In light of the market, technological and behavioral developments following the adoption of the CCD, the main goals of the CDD's review were to: (i) reduce consumer detriment and the risks of taking out loans in a changing market; (ii) facilitate the cross-border provision of consumer credit; and (iii) boost the competitiveness of the internal market, all the above in line with the original objectives of the CCD.

The options considered to achieve these objectives were: a no-policy-change scenario (Option 0 - baseline), non-regulatory intervention (Option 1); a targeted amendment of the CCD, focusing on making its current provisions clearer and more effective (Option 2); and an extensive revision of the CCD to include new provisions in line with existing EU laws (Option 3a) or to include new provisions going beyond current EU laws (Option 3b). Based on the impact assessment, the EU Commission selected Option 3a as the preferred option, accompanied by certain additional cost-effective measures taken from other options.[446]

The preferred option was assessed as very effective in achieving the initiative's objectives, ensuring a high level of coherence with EU legislation and efficiency in the economic and social impacts assessed. The preferred option is expected to have a positive effect on consumer protection, reduce detriment, build trust, and improve social inclusion. In addition, it is expected to strengthen the level playing field within and across the EU Member States, by reducing the fragmentation of the current legal framework.[447]

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[440] See, LE Europe, VVA Europe, Ipsos NV, ConPolicy and Time.lex, Behavioural study on the digitalisation of the marketing and distance selling of retail financial services, Final Report (April 2019).
[441] See, CIVIC Consulting, The Over-Indebtedness of European Households: Updated Mapping of the Situation, Nature and Causes, Effects and Initiatives for Alleviating its Impact, CIVIC Consulting Final Report (February 2013).
[442] See, CIVIC Consulting, Study on Measuring Consumer Detriment in the European Union, CIVIC Consulting Final Report (February 2017).
[443] See, EU Commission, Consumer Financial Services Action Plan: Better Products, More Choice, COM (2017) 0139 final (March 23, 2017).
[444] See, EU Commission, Mapping of national approaches in relation to creditworthiness assessment under Directive 2008/48/EC on credit agreements for consumers, EU Commission (2018).
[445] See, EU Commission, Commission Staff Working Document, Impact Assessment Report, Accompanying the Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, SWD (2021) 170 final (June 30, 2021); EU Commission, Commission Staff Working Document, Executive Summary of the Impact Assessment Report, Accompanying the Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, SWD (2021) 171 final (June 30, 2021).
[446] Ibidem.
[447] Ibidem.

4.6 The EU Commission's Proposed CCD II (July 2021)

The EU Commission published the proposed CCD II on July 1, 2021,[448] along with the Annexes to the draft directive,[449] the impact assessment report, [450] an executive summary of the report,[451] a Regulatory Scrutiny Board Opinion on the impact assessment,[452] and a factsheet.[453]

In its proposal, the EU Commission notes that, in light of various market, technological and behavioral developments since the adoption of the CCD, consumers taking out loans face detriment that could be avoided. In addition, businesses face burdens and costs from unclear obligations, which lower the competitiveness of consumer credit in the EU market.

In the accompanying press release, Vera Jourova, EU Commission Vice President for Values and Transparency, said: "[c]onsumers face many challenges, especially in the digital world which revolutionized shopping, services or financial markets. This is why we are stepping up consumer protection on two fronts: we are making it easier for consumers to avoid risks related to having a credit and we are putting even stronger rules for product safety in place. It will also put more responsibility on market players and make it more difficult for bad actors to hide behind complicated legal jargon."[454]

Didier Reynders, EU Commissioner for Justice, noted that: "[t]he Covid-19 crisis has impacted consumers in multiple ways and many have faced financial difficulties. The digitalization accelerated by the pandemic leads to a surge in online shopping and is profoundly changing the financial sector. It is our duty to safeguard consumers, in particular, the most vulnerable ones. With our revision of the existing EU rules on consumer credit and general product safety, that's exactly what we do!" [455]

The proposed revisions to the CCD include the following:[456]

- Extending the scope of the CCD to cover (i) credit agreements below Euro 200, (ii) credit agreements up to Euro 100,000, (iii) certain hiring and leasing agreements, (iv) credit agreements in the form of overdraft facilities, and where the credit has to be repaid within one month, (v) credit agreements where the credit is granted free of interest and without any other charges (including BNPL schemes) and credit agreements where the credit has to be repaid within three months and only nominal charges are payable, and (vi) crowdfunding credit services provided to consumers.[457]
- Adapting information requirements to ensure they cater for digital devices.

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[448] See, EU Commission, Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, COM (2021) 347 final (June 30, 2021).
[449] See, EU Commission, Annexes to the Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, COM (2021) 347 final (June 30, 2021).
[450] See section 4.5 and accompanying footnotes.
[451] Ibidem.
[452] See, EU Commission, Regulatory Scrutiny Board Opinion, Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, SEC (2021) 281 (April 23, 2021).
[453] See, EU Commission, Consumer Protection Revision of the Consumer Credit Directive, Factsheet (June 30, 2021).
[454] See, EU Commission, Consumer protection: Commission revises EU rules on product safety and consumer credit, EU Commission Press Release (June 30, 2021).
[455] Ibidem.
[456] See, EU Commission, Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, cit.
[457] Id., p. 7. Note in its proposal, the EU Commission clarifies that the protection of consumers granting credit through peer-to-peer lending platforms is not addressed as "it does not fit the logic of the proposal". Therefore, the protection of consumers investing through these platforms, and the responsibilities of the platforms towards these consumers will be assessed in another context.

- Making information related to credit offers clearer, reducing the amount of information to be provided to consumers in advertising, and focusing on key information through certain channels.
- More details on how and when pre-contractual information is presented to consumers to ensure it is done effectively.
- Banning practices that may exploit consumer behavior, such as pre-ticked boxes, product tying, and unsolicited credit sales.
- Allowing EU Member States to set caps on interest rates, the annual percentage rate of charge, or the total cost of the credit.
- Establishing conduct of business rules and obligations upon credit providers and credit intermediaries to ensure they put consumer needs first and act ethically and that their staff have appropriate knowledge, skills, and competence on credit.
- Improving rules on assessing consumer creditworthiness to ensure the assessment is carried out based on information on financial and economic circumstances, necessary, sufficient, and proportionate.
- Provisions on the use of alternative sources of data to conduct creditworthiness assessments, reflecting the principles of the General Data Protection Regulation (EU) 2016/679 ("GDPR").
- An obligation on the EU Member States to promote financial education to improve consumers' financial literacy.
- Supporting consumers who experience financial difficulties through forbearance measures and debt advice services.
- Improving conditions for enforcement by introducing an article on competent authorities.
- Fines of a maximum amount of at least 4% as set in the Omnibus Directive (EU) 2019/2161 for cross-border widespread infringements.

In its proposal, the EU Commission acknowledges that credit providers would bear most of the implementation costs of the new directive and some costs may be passed on to consumers.[458] Some measures would be more expensive for providers who are currently offering products not covered by the CCD (e.g. caps on interest rate, the annual percentage rate of charge or the total cost of the credit). The cost of the quantified measures for banks is estimated to be between Euro 1.4 billion and 1.5 billion.[459]

As indicated above, the proposed CCD II would widen the scope of the CCD to bring BNPL and other currently unregulated consumer credit products and services under the scope of the regulation. For instance, the proposed CCD II would require BNPL firms to provide clearer information to consumers and would prohibit them from soliciting consumers without their permission. In addition, the proposed CCD II would require credit checks and affordability assessments more widely by BNPL providers and would improve and strengthen the rules under which creditworthiness of consumers is assessed to tackle the risk of over-indebtedness and prevent dangerous debt build-up by customers.[460]

[458] Ibidem.
[459] Ibidem.
[460] Ibidem. See, also, Bernstein Group, EU Regulators Zoom in on Buy Now, Pay Later Boom | Expect Impact, Bernstein Group Insights (October 25, 2021); Protiviti, Buy Now, Pay Later ... and Gear Up for More Regulation | Protiviti Insights (2021); Hogan

The proposal is currently being examined by the EU Parliament and the Council of the EU and is expected to enter into force by 2024. The EU Parliament has published briefings on the proposed CCD II and the EU Commission's impact assessment on the proposal.[461] Within the EU Parliament, the file has been assigned to the Committee on the Internal Market and Consumer Protection ("IMCO"), which has been appointed as the lead committee to examine the proposal.

4.7 Opinions and Reports on the Proposed CCD II (August 2021 – January 2022)

The European Data Protection Supervisor's Opinion

On August 26, 2021, the European Data Protection Supervisor ("EDPS") published an opinion on the proposed CCD II.[462] In the opinion, the EDPS notes that the proposal has a clear impact on the protection of individuals' rights and freedom with regard to the processing of personal data, in particular considering the provisions concerning creditworthiness assessment, personalized offers based on automated processing and the use of personal data in the context of advisory and other activities.

To promote fair access to credit and data protection, the EDPS recommends delineating the categories and sources of personal data that may be used for creditworthiness assessment. The EDPS also recommends explicitly prohibiting the use of any special categories of personal data under Article 9 of the GDPR. In light of the possible adverse consequences for the individuals concerned, the EDPS considers that the requirements, role, and responsibilities of credit databases or third parties providing 'credit scores' should be addressed. Further clarifications should also be provided regarding the scenarios where consultation of external sources is necessary and proportionate.[463]

The EDPS notes that consumers should always receive meaningful prior information whenever their creditworthiness assessment is based on automated processing. Where the creditworthiness assessment involves the use of profiling or other automated processing of personal data, consumers should be able to request and obtain a human assessment. With regard to personalized offers on the basis of automated processing, the EDPS recommends introducing the obligation for the creditors to provide clear, meaningful, and uniform information about the parameters used to determine the price, and it encourages clear delineation of the categories of personal data that may be used as parameters to draw up a personalized offer.[464]

Lastly, the EDPS suggests explicitly confirming the full applicability of the GDPR to any processing of personal data falling within the scope of the proposal. Having regard to the Proposal for an AI Act, the EDPS recommends ensuring that the relevant consumer credit and data protection rules are integrated as part of the (third-party) conformity assessment process prior to CE marking.[465]

Lovells, Consumer finance regulatory news, July 2021, Hogan Lovells Insights (July 6, 2021); KPMG, Consumer Credit Directive, KPMG Report (November 2020); Allen & Overy, Key Regulatory Topics: Weekly Update 25 June to 1 July 2021, Allen & Overy (July 1, 2021); Allen & Overy, Key Regulatory Topics: Weekly Update 4 Feb to 10 Feb 2022, Allen & Overy (February 11, 2022).

[461] See, EU Parliament, Briefing, EU Legislation in Progress, Consumer Credit Directive, EU Parliament (October 2021).

[462] See, European Data Protection Supervisor (EDPS), EDPS Opinion on the Proposal for a Directive on Consumer Credits, EDPS Opinion 11/2021 (August 26, 2021).

[463] Id., p. 2.

[464] Ibidem.

[465] Ibidem.

The Committee on the Internal Market and Consumer Protection's Draft Report

On January 7, 2022, the IMCO published a draft report on the proposed CCD II.[466] The draft report was prepared by Rapporteur Kateřina Konečná and contains a draft EU Parliament legislative resolution with suggested amendments to the proposed CCD II.[467] The Annex to the draft report sets out a list of entities that provided input.[468] The key points of interest are set out in the explanatory statement to the draft report,[469] including the following:

- Scope - the Rapporteur is pleased to see that the EU Commission's proposal includes a broadening of the scope of the CCD. She acknowledges that digitalization has led to increased availability of credit products and an increased amount of new credit products that were not yet in the scope of the current CCD. She proposes to widen the scope of the CCD further to cover both hiring and leasing agreements, including leasing agreements without a purchase option. She then argues that peer-to-peer crowdfunding lending should not fall within the current scope of the CCD as the proposal does not sufficiently address associated issues. The Rapporteur proposes that the EU Commission comprehensively revise the CCD in 2024 at the latest, with particular focus on peer-to-peer crowdfunding lending.
- Advertising - the Rapporteur proposes a ban on personalized advertisements and an obligation to only show standardized offers. In addition, the requirements for advertisements should be extended with information on the implications and costs of missed payments. EU Member States should prohibit misleading advertisements that underexpose the consequences of a loan, risk creating over-indebtedness and focus on obtaining a loan.
- Pre-Contractual Information - the Rapporteur proposes providing pre-contractual information in the clearest possible way and suggests that the current SECCI form should be restructured, adding information on missed payments and the right of withdrawal.
- Creditworthiness Assessment - the Rapporteur agrees that data coming from social media should not be used in creditworthiness assessments and proposes a list of objective financial data that should be used to assess someone's creditworthiness. Any other type of data, specifically data on the consumer's health and medical situation or history with cancer should be prohibited to use.
- Caps – in light of the different situation and approach to the regulation of caps on annual percentage rate of charge and on total cost of credit in EU Member States, the Rapporteur suggests that EU Member States should have flexibility in the percentage or amount of the cap they choose and the possibility to set additional caps (e.g., the maximum amount of fees).
- Debt Collection - the Rapporteur proposes changes to reduce the burden on persons facing difficulties paying back their loans. When eventually a loan does end in debt-collection, more

[466] See, EU Parliament Committee on the Internal Market and Consumer Protection (IMCO), Draft Report on the Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, COD 2021/0171 (January 31, 2022).
[467] Id., pp. 5 - 63.
[468] Id., p. 66.
[469] Id., pp. 63 - 66.

rules on debt collection would increase the effectiveness and consumer-friendliness of the process. The Rapporteur proposes a new article on debt collection, laying down rules on the debt collection process.

- Green Loans - the Rapporteur acknowledges that environmentally sustainable consumer loans are currently limited across Europe. Applying a lower cap for green consumer loans is important to ensure that consumers have access to affordable financing to help them fulfill their green projects. To that end, the Rapporteur suggests that the EBA (along with stakeholders from the industry and consumer representatives) should develop a range of standardized, environmentally sustainable consumer credit products.

The Economic and Monetary Affairs Committee's Draft Opinion

The EU Parliament Committee on Economic and Monetary Affairs ("ECON") published a draft opinion on the proposed CCD II dated January 27, 2022.[470] The draft opinion aims to complement the EU Commission's proposal with additional measures to enhance consumer protection while keeping the right balance with credit providers' duties, including the following: [471]

- Preventing household over-indebtedness – ECON suggests tightening the conditions under which credit can be granted when the creditworthiness assessed is negative and introducing caps on charges such as the annual percentage rate. In addition, it recommends that consumers should benefit from better financial education and information on products, and from additional time to understand and compare offers. To this aim, a Standard European Consumer Credit Overview (SECCO) should summarize the key elements of the credit in a graphical form, in addition to the SECCI form.

- Digitalization – in light of the consequences of the digitalization of financial services on consumer data protection, ECON suggests that the type of consumer data used to define personalized offers and creditworthiness assessments should not include sensitive data, as set out in the GDPR.

- Green finance - to support the greening of the EU economy, ECON proposes more favorable credit conditions regarding socially and environmentally sustainable products.

ECON has called on the IMCO, as the committee responsible, to consider its suggested amendments.

[470] See, EU Parliament Committee on Economic and Monetary Affairs (ECON), Draft Opinion on the Proposal for a Directive of the European Parliament and of the Council on Consumer Credits, COD 2021/0171 (January 27, 2022).
[471] Id., pp. 3 and 4.

CHAPTER 5

MOVING AHEAD

5.1 What's Next for BNPL?

Consumers are becoming more conscious about their financial needs and increasingly look for new ways to save and spend wisely and manage their finances more efficiently. This includes a long-term shift away from traditional forms of credit, embracing greater flexibility, and adopting new technologies. Compounded by the recent Covid-19 pandemic, evolving customer expectations alongside technological advances are driving innovation that prioritizes transparent, real-time, and frictionless transactions. BNPL solutions are primed for the direction customers are headed to, and the improvements and innovations that BNPL providers can bring to the financial sector are significant.

As consumers seek alternative financing methods, BNPL products continue to rise in popularity. Although it is still in the early innings, the BNPL market has been rising rapidly and is expected to grow further over the next few years. Competition is quickly mounting as companies from various sectors join the race and increasingly challenge the BNPL specialists. This will likely exert increasing pressure on merchant fees and margins. Consolidation is also expected to continue as certain BNPL players come to dominate in various geographies and acquire smaller rivals.

As the BNPL market continues on its rapid growth trajectory, established BNPL providers are expected to expand into deeper, more connected, and more frequent relationships with customers. Thus far, fintech companies have taken the lead and have captured most of the value being created in the BNPL market. Fintech BNPL providers continue rethinking and redesigning BNPL products to make them more suitable and appealing to customers and businesses. For example, interesting functionalities being explored include open-banking powered consolidators (to provide customers with a consolidated view of their installment payments from multiple credit providers in one place), BNPL debt managements tools (to help customers track their spending and borrowing and repay their debt timely), as well as innovative integrations of virtual cards and digital wallets with BNPL solutions. Further compelling propositions BNPL providers are considering include innovative features to help merchants manage cash flows and link them to sales and marketing metrics more seamlessly and efficiently.

In terms of market strategy, some fintech BNPL players will likely continue focusing on servicing e-commerce merchants across an increased number of new BNPL verticals and potentially branch into in-person consumption channels. Certain BNPL fintech companies are expected to cross into trade and business-to-business finance. Other fintech BNPL players with higher levels of consumer loyalty and more active customer bases are more likely to broaden the scope of their activities and build significant scale and engagement through the entire customer journey via "super apps" to offer a complete integrated ecosystem of financial and non-financial products and services shaped around users' everyday needs.[472]

[472] See, e.g., FT Partners, Buy Now Pay Later, Revolutionizing Traditional Credit With Convenience, Data & eCommerce, cit; Rodney Bain, What to expect from the next stage of 'Buy Now, Pay Later, AltFi (April 1, 2022); Sifted, What's next for buy now, pay later? 6 insights from our panel, Sifted (January 18, 2022).

While fintech BNPL providers are innovating at speed, the growth trajectory of the BNPL market has large technology companies and financial incumbents paying close attention, with a few of them deploying BNPL strategies and increasing their efforts to improve the digital user experience. More and more large technology companies and financial incumbents see BNPL as a strategic area to deepen customer relationships and are considering the right BNPL business model to focus on, the verticals to prioritize, and how to go to market. Their future decisions will be key to watch as they leverage their extensive merchants and partners networks, and customer bases and seek to evolve their offerings in response to consumers' rapidly changing expectations and needs. Whichever approach they choose, large technology companies and financial incumbents must recognize that BNPL is part of a broader transformational change of finance and banking into a more transparent, open, connected, and experience-driven ecosystem.

In parallel, several "auxiliary" businesses and activities are likely to grow in the wake of a global BNPL expansion to improve backend processing and the infrastructure used to execute BNPL transactions, covering areas such as fraud detection and refunds, collections, and chargebacks, among others. BNPL firms are well-positioned to take advantage of these adjacent opportunities through acquisitions, collaborations, and strategic partnerships.

As BNPL continues to evolve, the regulatory climate heats up. As discussed in prior sections, compared to other providers of more traditional forms of credit, BNPL lenders have been enjoying greater flexibility and have been largely operating outside of existing regulatory frameworks. However, regulatory scrutiny has intensified in recent months. Regulators across the United States, the United Kingdom, and Europe are now deliberating on the implications of BNPL models, are investigating the benefits and dangers created by BNPL offerings, and are assessing how to draw the boundary for BNPL regulation appropriately and proportionally to the associated risks. As with any fast-growing industry, the interplay between innovation, technology, and regulation will be a delicate balancing act. Future regulatory activity will need to be proportionate and balance the need to strengthen consumer protection and increase transparency and efficiency in the BNPL market, while also ensuring continued access to BNPL by customers and merchants and allowing innovation to flourish. Determining the appropriate scope of any future regulatory intervention in the BNPL market will require a nuanced analysis of evolving consumer behaviors and needs, and an in-depth examination of consumer benefits and risks.

As specific legislative and regulatory proposals for BNPL are being published and new rules and guidelines are being considered, BNPL providers and merchants will need to carefully assess and strengthen their regulatory position in the near term. BNPL providers are encouraged to proactively address relevant risks and promptly tackle identified areas of concern. Going forward, transparent, clear, and fair BNPL terms and conditions, coupled with an intuitive, seamless, and flexible user experience will play an increasingly important role in creating a best-in-class customer journey and better outcomes for customers and businesses. In addition, BNPL lenders will need to provide more transparent guidance, simple communications, and educational initiatives to increase customers' awareness, help consumers understand how BNPL works and how to use it responsibly, and empower them to make informed decisions. Furthermore, those BNPL providers who accelerate the work to build robust compliance

procedures, improve risks and economics models, eligibility checks, and creditworthiness assessments mechanisms (covering both credit risk and affordability), enhance data sharing mechanisms, and increase consumer protections and guardrails (including in relation to the right to return a purchase or help available for unexpected financial hardship and complaint handling processes) will be able to provide greater control and value to the end consumers, while also gaining increased visibility and a better understanding of their credit and financial behavior. To remain relevant, BNPL firms will also need to carefully assess the impact of the evolving macro context of inflation and the shifting economic outlook on their performance and their customers' spending and financing activities.

Undoubtedly, careful planning and common industry standards will play a pivotal role in delivering responsible credit alternatives and promoting long-term sustainable growth in the BNPL market, which can help enhance the benefits and value to consumers and businesses, unlock consumer financial power and improve companies' economics. BNPL providers should constructively collaborate with regulators and policymakers to enhance the understanding of consumer needs and outcomes. Informed guidance by regulators and policymakers and collaboration between them and the BNPL industry will be critical to shaping the future of the BNPL market, while continuing to offer consumers innovative and empowering choices to manage their finances effectively.

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